Palisade
CAPITAL MANAGEMENT

First Quarter
2023

Private Wealth Management

2023 Q1 Review…and Outlook

	1Q23 Performance
S&P 500® Index	7.5%
Dow Jones Industrial Average	0.9%
NASDAQ Composite Index	17.1%
Russell 2000® Index	2.7%
VIX Volatility Index	-13.7%
Barclays U.S. Aggregate Bond Index	3.0%
10-Year U.S. Treasury Yield	-10.3%
Baltic Dry Index – Spot (Ocean Cargo Shipping Rate)	-8.3%
Gold ($ per ounce) – NY Spot	8.0%
Oil ($ per barrel – West Texas intermediate)	-5.6%
Bitcoin ($)	72.6%

Source: FactSet Research Systems, Inc.

Investors' New Worry: Banks. Over the last year, we had growing concerns that something would break in the financial system as a result of the size and speed of interest rate increases. We weren't sure which companies or industries would feel the pain, but we now have our answer. On March 10, Silicon Valley Bank (SVB), America's 16th largest bank, was declared insolvent by the Federal Deposit Insurance Corporation (FDIC). The storied bank that had served its technology clients so well for nearly 40 years collapsed in just 40 hours. What happened? *First*, SVB had a large deposit base spread over a thin clientele of tech-focused companies, entrepreneurs, and affluent families. By one estimate, 88% of the bank's customers carried deposit balances in excess of the FDIC's $250,000 insurance limit. By comparison, the retail banking customers of JPMorgan (the "Chase" brand) had an average 2022 deposit balance of less than $15,000; JPMorgan Chase is the country's largest bank by total assets as of December 31, 2022. So, unlike customers of most large banks, many SVB depositors risked losing most of their deposits if the bank failed. But the *second* occurrence – the one that tripped alarms – was SVB's liquidity crisis: customers demanded the return of their deposits when the bank revealed a $2.4 billion hole in its investment account. The bank had invested its excess cash (deposits grew by *70%* during Covid (2020-2022)) in low-coupon treasury bonds, which then lost value when the Federal Reserve Bank raised interest rates quickly and sharply last year (bond prices fall when interest rates rise). The bank tried to sell its marked-down bond portfolio while simultaneously attempting to raise enough new equity to fill that hole. Word got out that the bank was in trouble, and its tech-savvy depositors created an "e-run" on the bank by moving funds out of the bank with just a few clicks on their screens. The major difference between the bank run on the fictional Bailey Building & Loan in the 1947 movie *It's a Wonderful Life* (photo above) and SVB is that Jimmy Stewart's customers had to come into the bank lobby and speak with the manager to withdraw their deposits. SVB's customers had no such hurdles.

Fear radiated out from SVB to the general banking system on March 8-10. New York-based Signature Bank, another boutique bank catering to wealthy individuals and to crypto currency investors, failed the same weekend as SVB. There are 50 or so mid-sized regional banks in the U.S. and thousands of community banks. The four largest American banks – JPMorgan Chase, Bank of America, Citigroup, and Wells Fargo – hold nearly 35% of all bank deposits in the United

States and are deemed systemically important ("too big to fail") by regulators. Financial authorities offer no implicit backstop for depositors in smaller banks beyond basic FDIC insurance ($250,000). The dilemma federal regulators faced on the weekend of SVB's collapse was whether to let SVB depositors risk losing their uninsured deposits and potential widespread panic, or to backstop SVB depositors and risk "moral hazard" – that is, cleaning up others' messes with limited consequences for the miscreants. The Fed chose the second course by guaranteeing *all* SVB (and Signature Bank) deposits. The economic consequences of *not* following this course might have been more serious than courting moral hazard: panic among other regional bank depositors and raising the odds of economic recession.

Lessons for Investors After SVB. Through the quick actions of regulators, SVB depositors were rescued (though not the bank's investors or executives). An uneasy calm has returned to the U.S. financial markets in the last few weeks. But SVB has taught investors four important lessons which we'd be wise to remember:

- **Banks can be fragile**. Banks' ability to exist – to take deposits and make loans – depends on the trust of their depositors, regulators, and investors. And trust can be fragile. The 4,700 U.S. banks that are members of the FDIC network (virtually every bank in America) have just $0.11 of equity for every dollar of deposits and $0.09 of equity for each dollar of assets. That's significant leverage which reveals the critical importance of prudent bank management and careful supervision. There are no libertarians in a banking panic.
- **Deposits can move around the banking system at the speed of light**. The same smartphone that displays the rumor of a bank's illiquidity can be used seconds later to move deposits out of a bank. SVB bankers, for all their tech savvy, also tripped on this. Even if there had *not* been a panicky run on the bank, SVB was facing deposit outflows from clients seeking better returns than those offered by the bank's demand deposits and CDs. Today, short-term treasury bills offer a safe, liquid, and higher yielding alternative to bank deposits.
- **We should view estimates of banks' tangible net worth with skepticism.** Given the swiftness with which financial capital can mobilize and the high degree of financial leverage in the banking system, we should view calculations of banks' tangible net worth with caution. Until March 9, analysts calculated Silicon Valley Bank's tangible net worth at $200 per share (as of December 31, 2022). A day later it was zero.
- **Invest in the best financial institutions** that have a long track record of delivering financial results with a management team that has been through other periods of financial stress. As investors, we have long favored large, well-managed banks that have a very broad depositor base and diversified business model offering services such as asset management, merger and acquisition advice, and capital markets services.

What Does This Mean for Investors? So far, $755 billion has been pumped into the financial system to avert a domino effect of other banks suffering the same fate as SVB and Signature Bank. Recent data tracking money market flows (slowing deposits to money market funds) are an indicator that bank deposits have stabilized. However, regional bank issues have not been resolved. We believe it is likely there will be further regulation raising the cost of capital. Bank mergers could also be a solution; however, Washington does not seem to have much appetite for creating another big bank. Do bank failures and the regulatory response that follows cause recessions, or do tighter monetary conditions cause banks to fail? Whatever the causality, bank failures and harsher monetary policies tend to go hand in hand. It can be challenging for banks to extend credit when their source of funding, customer deposits, can quickly leave for better returns elsewhere (treasury bills, for example). Higher borrowing costs also dull borrowers' appetite for loans.

The Federal Reserve has raised interest rates nine times in the past 12 months, moving the funds rate from zero to 5%. This has been the Fed's fastest and sharpest rate rise in 40 years. Stresses are beginning to show, especially in the housing, banking, and commercial real estate sectors The bond market appears to be betting the Fed will *cut* rates before the end of the year. We are skeptical of that, given Chair Powell's oft-stated view that the Fed's job will not be done until consumer inflation has dropped to 2%. Chair Powell does not want to be seen as a vacillating Fed leader, like those who preceded Paul Volcker in the 1970s – and who utterly failed to tame inflation. With that as the backdrop for the economy, we continue to focus on companies with under-leveraged balance sheets that generate strong free-cash flow and which can potentially take advantage of lower corporate asset prices. The strongest companies can make acquisitions or buy back their own debt or stock, allowing them to grow profits despite a difficult macro landscape.

Reaction to the bank drama of early March has been both peculiar (renewed interest in both cryptocurrency and cash-rich technology shares, for example) and predictable (gold up sharply), but $755 billion of liquidity injections certainly explain some of the recent moves by these sectors. We DO think the Fed will proceed with slower and smaller rate increases from here, and that the equity markets may begin to anticipate the start of a new economic cycle, perhaps before the end of this year. Though the environment remains challenging, we are reminded that when money is no longer free, it gravitates to places where it is going to be treated kindly. We expect equity benchmarks to mark time between now and then, but believe that a portfolio of high quality, reasonably valued, free cash flow-generating companies can do well in this environment.

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

Sincerely,
Palisade Capital Management

PRIVATE WEALTH MANAGEMENT TEAM

JACK FEILER
VICE CHAIRMAN, EMERITUS

MICHAEL FEILER
MANAGING DIRECTOR,
PRIVATE WEALTH MANAGEMENT

BERNARD PICCHI, CFA
MANAGING DIRECTOR,
PRIVATE WEALTH MANAGEMENT

WENDY POPOWICH
MANAGING DIRECTOR,
PRIVATE WEALTH MANAGEMENT

LORRAINE R. SALVO, CFP®, CDFA®
MANAGING DIRECTOR,
PRIVATE WEALTH MANAGEMENT &
HEAD OF FINANCIAL PLANNING

DENNISON "DAN" T. VERU
CHIEF INVESTMENT OFFICER

CLIENT RELATIONS TEAM

CATHERINE CARPENTER
ASSISTANT VICE PRESIDENT,
CLIENT RELATIONS & STRATEGIC INITIATIVES

ROSEANN HEFFERNAN
ASSISTANT VICE PRESIDENT,
CLIENT RELATIONS

ARELY QUINTANILLA
ASSOCIATE,
CLIENT SERVICES & TECHNOLOGY

INVESTMENT SOLUTIONS TEAM

FRANK GALDI
MANAGING DIRECTOR,
CHIEF RISK OFFICER & DEPUTY CHIEF INVESTMENT OFFICER

AMRITA THAPA, CFA
SENIOR VICE PRESIDENT,
INVESTMENT MANAGER RESEARCH & RISK MANAGEMENT

IMPORTANT INFORMATION

The information contained herein reflects the view of Palisade Capital Management, LP and its affiliates (collectively, "Palisade" or the "Firm") as of the date of publication. These views are subject to change without notice at any time subsequent to the date of issue. All information provided in this letter is for information purposes only and should not be deemed as investment advice or a recommendation to purchase or sell any specific security.

Certain information contained herein has been obtained from third party sources and such information has not been independently verified by Palisade Capital Management, LP. No representation, warranty, or undertaking, expressed or implied, is given to the accuracy or completeness of such information by Palisade Capital Management, LP, or any other person. While such sources are believed to be reliable, Palisade Capital Management, LP does not assume any responsibility for the accuracy or completeness of such information. Palisade Capital Management, LP does not undertake any obligation to update the information contained herein as of any future date.

Certain information contained in this letter constitutes "forward-looking statements," which can be identified by the use of forward-looking terminology such as "may," "will," "should," "expect," "anticipate," "project," "estimate," "intend," "continue," or "believe," or the negatives thereof or other variations thereon or comparable terminology. Due to various risks and uncertainties, actual events, results, or the actual performance of investments may differ materially from those reflected or contemplated in such forward-looking statements. Nothing herein may be relied upon as a guarantee, promise, assurance, or a representation as to the future.

The S&P 500® Index is an unmanaged index that is widely recognized as an indicator of general market performance, based on the market capitalizations of 500 large companies having common stocks listed on the NYSE or NASDAQ. The S&P 500® Index does not have a defined investment objective, nor does it charge fees and expenses.

The Dow Jones Industrial Average (The Dow) is a price-weighted measure of 30 U.S. blue-chip companies. The index covers all industries except transportation and utilities.

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

The Russell 2000® Index (the "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 2023. FTSE Russell is a trading name of certain of the LSE Group companies. Russell® is a trade mark(s) 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 Bloomberg Barclays U.S. Aggregate Bond Index covers the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities.

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.

contracts. reported around the world as a proxy for dry bulk shipping stocks as well as a general shipping market bellwether.

This information is confidential and for the use of the intended recipients only. It may not be reproduced, redistributed, or copied in whole or in part for any purpose without prior written consent. This document is not intended for distribution to, or use by, any party in any jurisdiction where such distribution or use would be contrary to local law or regulation. Certain information included in this document has been obtained from third-party sources believed to be reliable. No assurances can be given that such information is accurate.

Investing in securities involves risk, including the risk the entire amount invested may be lost. Securities investments are not guaranteed. Palisade's valuation predictions may not be correct and/or achieved within the anticipated time frame. Fixed income securities are generally subject to interest rate risks. The risk is greater for long-term securities than for short-term securities. A risk in a long-term purchase strategy is that Palisade may not take advantage of short-term gains that could be profitable. Moreover, if Palisade's predictions are incorrect, a security may decline sharply in value before being sold. Conversely, a risk in a short-term purchase strategy is that Palisade may incorrectly predict the performance of a security over a short period of time, and we may not take advantage of long-term gains that could be profitable. Equity and equity-linked securities fluctuate in value in response to many factors, including the activities and financial condition of individual companies, the business market in which individual companies compete, industry market conditions, interest rates, and general economic environments. REITS are affected by underlying real estate values, which may have an exaggerated effect to the extent those REITs concentrate investments in particular geographic regions or property types. A company issuing convertible securities may default. Palisade's portfolios are susceptible to operational, information security, and related risks from cyber security incidents resulting from deliberate attacks or unintentional events.

Palisade is an SEC registered investment management firm established in 1995. Based in Fort Lee, NJ, the Firm manages a variety of assets for a diversified client base, including institutions, foundations, endowments, pension and profit-sharing plans, retirement plans, mutual funds, private limited partnerships, family offices, and high net worth individuals. Registration with the Securities and Exchange Commission does not imply a certain level of skill or expertise.

Past performance is not a guarantee of future results.

Please note, 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.