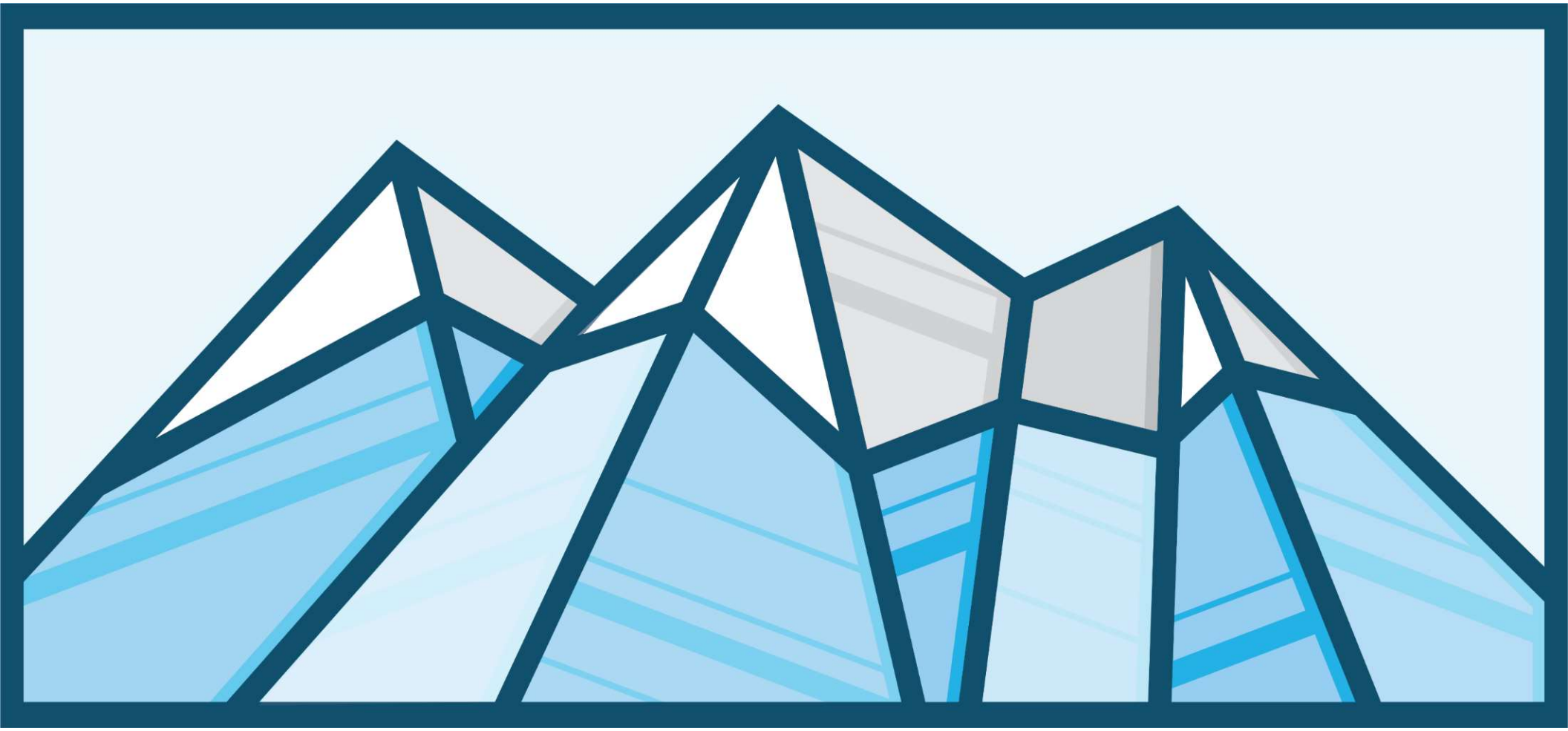

PALISADE CAPITAL CLIENT UPDATE

Week 3 Update: COVID-19 Market Impact, Risk Management & Forward Outlook

March 30, 2020

Key Principles Intact

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<u>These next two slides are the same as the previous two weeks, just in case some clients are seeing this presentation for the first time</u>

- We are living through a unique global risk event that has spawned a bear market that has enveloped all sectors of the economy
- Part of the investing process is dealing with bear markets and sticking to key investing principles (great opportunities are created)
- Palisade partners are substantially invested in all funds alongside our clients
- Protecting capital is our first priority
- We will voraciously be looking for new investment opportunities to take advantage of the decline in prices with the goal of providing above market returns in the future as the markets recover

First Priority – Defense and Patience

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- We are in the middle of a bear market. This will not be over tomorrow, but the high degree of volatility we are seeing typically leads to excellent buying opportunities.
- Simply recognizing that we are in a bear market means that defence needs to be our first priority. Capital preservation.
- Patience is the second priority because we are going to see a high degree of volatility for the next few weeks and/or months. This isn't a correction. Time is required to work through the damage that has been done in the last month.
- We don't need to catch the exact low to provide a substantial medium and long term return.

Bear Market Example – 1987

- Peak to trough decline of 34%
- Post initial crash market moved sideways in 10% range for two months, revisited lows then sustained move to old highs in 17 months

General Fund Commentary

- Memories of 2008 – month end rallies based on rebalancing and "window dressing"
- Liquidity of the Funds and the banking system are very high. Funds have no privates and largely highly liquid mid and large-cap positions
- Government stimulus and asset purchase programs are ensuring liquidity within the financial system. Palisade fund assets are held at National Bank and TD Bank
- Time to recovery from a bear market in the 25% - 35% decline range can be as quick as 3 months up to 20 months (see next slide)
- Long term returns from current levels are very attractive historically, based on post WWII examples (see next two slides)

Bear Market Breakeven Timeframe

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How Long Does is Take to Breakeven?

Peak	Trough	Drawdown	Months	Years
9/7/1929	6/1/1932	-86.2%	159	13.3
9/7/1932	2/27/1933	-40.6%	3	0.3
7/18/1933	10/21/1933	-29.8%	22	1.8
2/6/1934	3/14/1935	-31.8%	6	0.5
3/6/1937	3/31/1938	-54.5%	77	6.4
11/9/1938	4/8/1939	-26.2%	46	3.8
10/25/1939	6/10/1940	-31.9%	32	2.7
11/9/1940	4/28/1942	-34.5%	10	0.8
5/29/1946	10/9/1946	-26.6%	36	3.0
6/15/1948	6/13/1949	-20.6%	6	0.5
7/15/1957	10/22/1957	-20.7%	10	0.8
12/12/1961	6/26/1962	-28.0%	11	0.9
2/9/1966	10/7/1966	-22.2%	6	0.5
11/29/1968	5/26/1970	-36.1%	20	1.7
1/11/1973	10/3/1974	-48.2%	46	3.8
9/21/1976	3/6/1978	-19.4%	13	1.1
11/28/1980	8/12/1982	-27.1%	3	0.3
8/25/1987	12/4/1987	-33.5%	17	1.4
7/16/1990	10/11/1990	-19.9%	4	0.3
7/17/1998	8/31/1998	-19.3%	3	0.2
3/24/2000	10/9/2002	-49.1%	48	4.0
10/9/2007	3/9/2009	-56.8%	37	3.1
4/29/2011	10/3/2011	-19.4%	4	0.3
9/20/2018	12/24/2018	-19.8%	4	0.3

Source: Ben Carlson www.awealthofcommonsense.com

- Range to recovery for 25% to 35% decline ranges from 3 to 20 months
- Even the more substantial 57% decline in 08/09 was recovered in a reasonable timeframe of 3 years

Long Term Returns Post Bear Market

			Forward Returns		
Drawdown	Peak	Trough	1 Year	3 Years	5 Years
-86.2%	9/7/1929	6/1/1932	162.9%	170.5%	344.8%
-56.8%	10/9/2007	3/9/2009	53.6%	97.9%	181.6%
-54.5%	3/6/1937	3/31/1938	35.2%	38.2%	84.5%
-49.1%	3/24/2000	10/9/2002	24.4%	59.0%	105.1%
-48.2%	1/11/1973	10/3/1974	38.1%	72.7%	117.5%
-40.6%	9/7/1932	2/27/1933	98.7%	194.5%	154.6%
-36.1%	11/29/1968	5/26/1970	34.7%	50.6%	42.2%
-34.5%	11/9/1940	4/28/1942	61.2%	128.6%	144.9%
-33.5%	8/25/1987	12/4/1987	23.2%	55.5%	121.7%
-31.9%	10/25/1939	6/10/1940	8.0%	59.7%	118.8%
-31.8%	2/6/1934	3/14/1935	83.8%	16.3%	84.9%
-29.8%	7/18/1933	10/21/1933	2.9%	120.1%	87.3%
-29.2%	2/19/2020	???	???	???	???
		Averages	52.2%	88.6%	132.3%

Source: Ben Carlson www.awealthofcommonsense.com

- One-year returns range from 23% to 54%
- Three-year returns range from 50% to 98%
- Five-year returns range from 42% to 180%
- These returns are based off the market decline example previously

Current Fund Positioning

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Select Fund

- 42% Cash. 20% Oil and Gas. 11% Infrastructure. 11% Renewable, tech
- Cash balances down 10% since last week. Added lightly to high quality balance sheets in energy and a wide group of renewables companies
- Need to recognize that energy has additional challenge of OPEC+ when allocating capital back into equity positions

Vantage Fund

- 15% Cash. 22% Financials. 13% Utilities. Balance in Telecom, REITs, Diversified
- Market likely favours defensive yield and growth post recovery given slow growth environment until stimulus effects are evident – Fund is well positioned in these areas

Absolute Fund

- 11% Short. 30% Long. 59% cash. Have moved to a slightly net long position to take advantage of long term value and month end rebalancing

- Cash weightings can become more defensive if we deem necessary, but we are close to a point of sitting tight with cash and focusing research on long ideas

Guideposts for Recovery – What We're Watching For

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Market Oriented

- Quick decline in volatility below VIX reading of 30 – not yet
- Interest rates on 10 year US Treasury bonds move higher above 1.05%. On longer term basis moving above 1.4% would solidify – briefly but liquidity driven
- Hard to define, but looking for market to do something positive in the face of negative news (ie. market makes unexpected move) – not yet
- Japanese Yen weakness (Yen is a safe haven currency) – yes, but liquidity

Government Oriented

- Increased fiscal programs to improve economic stability - ongoing
- A slowing growth rate of new coronavirus cases in Europe (assumes North America will follow) due to aggressive response – yes, but early
- The key is the length of time to emerge on other side. Quicker and more aggressive response is key – ongoing. See NY and CA shelter in place

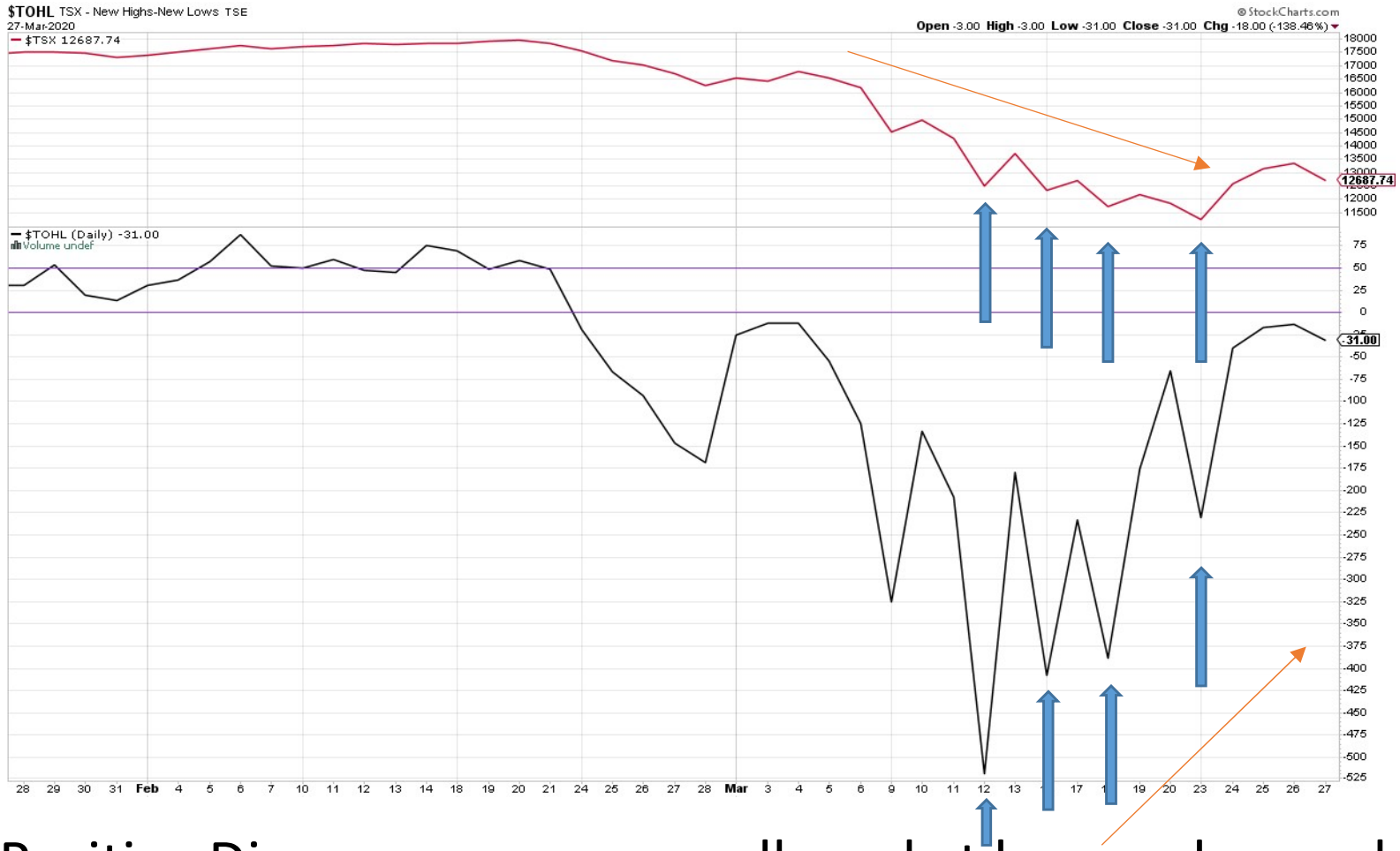
Market Negative/Neutral (?) - Volatility

- Volatility has come down from peak readings of 85 (likely will be the high barring unforeseen acceleration in Covid-19 damage), but is still very elevated overall in mid 60's

Market Negative – US 10 Year Yields

- After a brief move higher two weeks ago, yields continue to remain near lows. Interest rates at the Federal Reserve are zero, but we should still be able to see a bit of an increase in rates with a recovery in sight

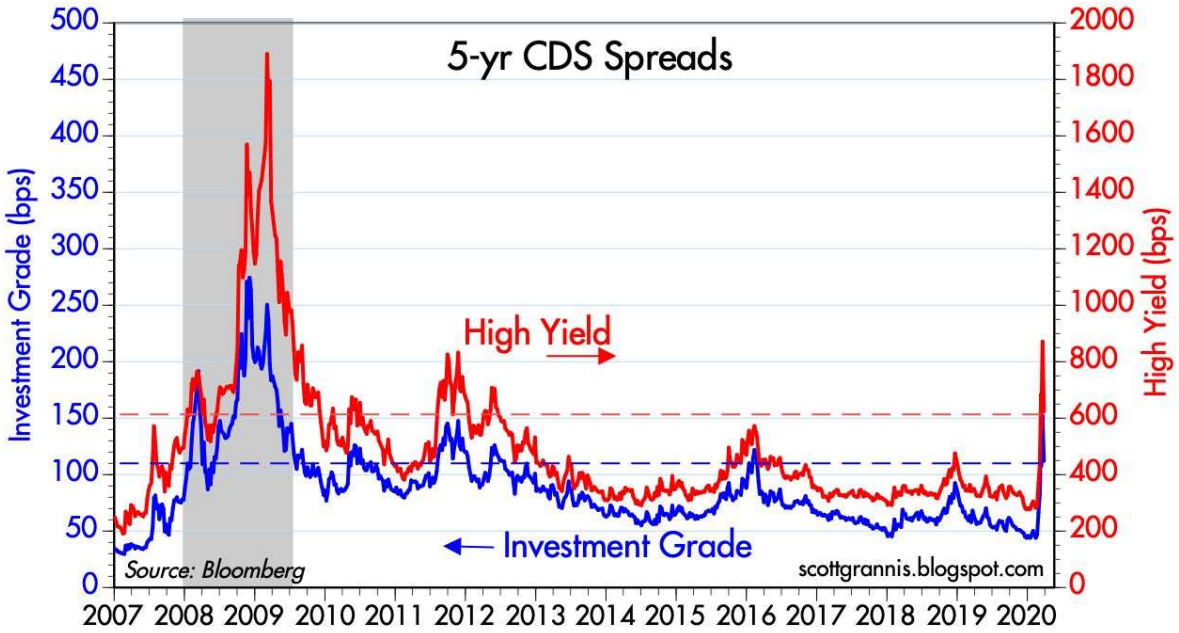
Market Positive – TSX Breadth



- Positive Divergence – as overall market has made new lows (red line) the number of stocks making new lows is improving (black line)

Market Positive – Lower Financial Fear

- Chart shows the cost to insure investment grade corporate bonds and high yield (ie. non-investment grade) bonds in the US
- Chart shows back to 2008/2009 for perspective
- While insurance costs spiked initially, that cost has come down in the last week
- Still elevated and early days, but the pullback on announced government monetary and fiscal stimulus packages is a positive



Market Positive – IG Corporate Bonds

- Investment grade corporate bonds have recovered substantially in the last week
- Important to note that they were up on Monday when the stock market was down (blue arrow)

Contact Information

A founding principle of Palisade has always been transparency and communication with our clients. We would encourage anyone with questions to reach out at anytime.

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