

# SHORT DURATION BONDS: OPPORTUNE TIME FOR INVESTING

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With the Federal Reserve’s long-awaited rate-cutting cycle now underway, multiple factors are converging that we believe makes this an opportune time to “go long” short duration bonds.

Financial markets had priced in a 50-basis point cut by the Federal Reserve and on September 18th the Fed delivered on expectations. This may finally force investors in money market funds to confront the reinvestment risk inherent in their portfolios. With elevated yields on the short end of the curve and the uncertain pace of further rate cuts, we believe investors can take advantage of opportunities in short duration corporate bonds, rather than endure the risk of longer duration fixed income. In particular, short duration corporate bonds with convertible features can potentially achieve attractive yields with limited interest-rate risk.

As of September 24, 2024, the Federal Fund futures are forecasting an additional 150 bps of rate cuts by March 2025. We expect that the front end of the curve will rally as expectations grow that short-term yields will fall more than long-term yields. Short duration debt may also gain as lower rates could spur proactive liability management as issuers seek to refinance nearer-dated issues to extend maturities and lower costs. In the case of Palisade’s Short Duration Bond strategy (the “Strategy”), the holdings could further benefit from equity upside.

A newly funded portfolio comprised of bonds within the Strategy meeting the purchase criteria on August 31, 2024 (a “Palisade NFP”) would have a median yield of 5.27% and a duration of 0.96 years. This is 85 bps greater than the weighted average yield of core fixed income as of August 31, 2024 with significantly less duration exposure.

AS OF 8/31/2024	YIELD	DURATION
Palisade NFP	5.27%	0.96
Bloomberg U.S. Aggregate	4.42%	6.16

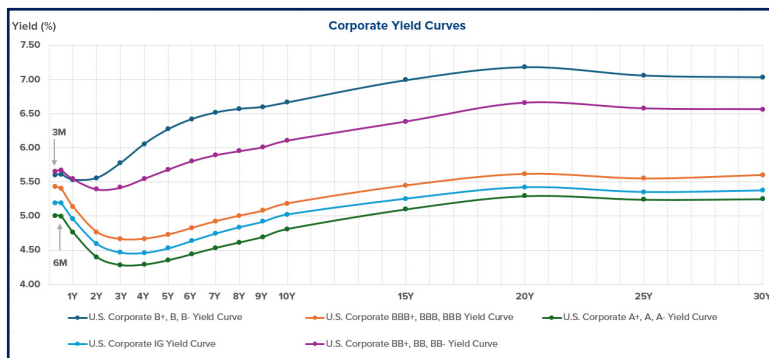
Source: Palisade, Bloomberg, LP

Given the differentiated nature of the holdings, the Strategy can provide diversification from a traditional core fixed income allocation. The Strategy has historically produced higher returns compared to the Bloomberg U.S. Aggregate Bond Index, while maintaining lower interest rate risk (duration).

PERFORMANCE AS OF 8/31/2024	Year To Date	1 Year Trailing	3 Year Trailing	5 Year Trailing	7 Year Trailing	Inception To Date (2/29/16)
Short Duration Bond Composite (Gross)	3.83%	6.70%	2.37%	5.32%	5.00%	5.63%
Short Duration Bond Composite (Model Net)	3.27%	5.84%	1.56%	4.49%	4.18%	4.80%
Bloomberg U.S. Aggregate Bond Index	3.07%	7.30%	-2.11%	-0.04%	1.21%	1.49%
Variance (Gross)	+0.76%	-0.60%	+4.48%	+5.36%	+3.79%	+4.14%

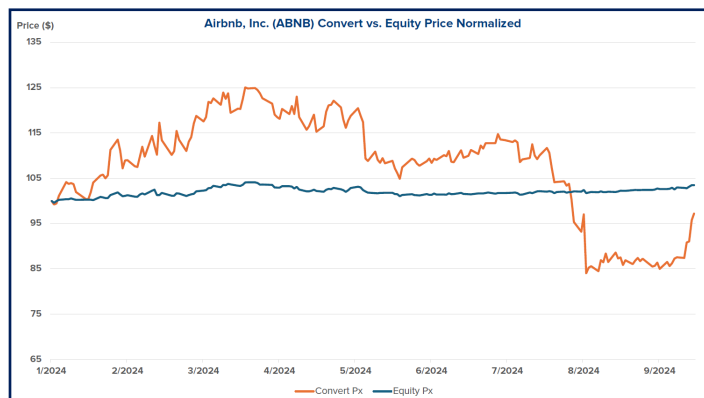
Source: Palisade. Short Duration Bond Composite net performance is reduced by a model fee of 0.78% annually. Actual investment advisory fees incurred by clients may vary.

We believe longer duration bonds within the Bloomberg U.S. Aggregate Index may not offer adequate incremental yield given macroeconomic uncertainty and recent interest rate volatility. The chart to the right shows various rate curves by ratings for corporate debt. For investment grade credits, there does not appear to be an incentive to invest further out on the curve because no incremental yield is generated until maturities exceed 10 years. We do not believe the higher return offered in the longer tenors adequately compensates investors for the uncertain macroeconomic environment over such a long time period.

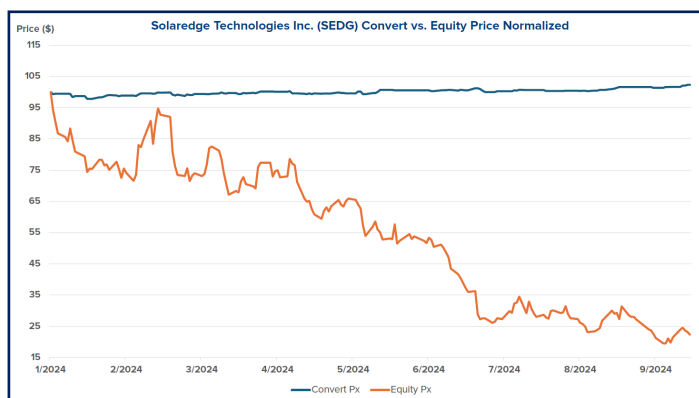


Source: Bloomberg, LP. As of 8/31/2024.

Potential downside scenarios involving higher interest rates and/or weak equity markets should have less impact on the Strategy due to its focus on maturities or put dates of three-years or less and the focus on companies with liquid balance sheets and visible credit profiles. The graphs below show the top two issuers by weight in the Strategy. In both cases, equity performance had a minimal impact on the bond price.



Source: Bloomberg, LP. YTD thru 9/20/2024.



Source: Bloomberg, LP. YTD thru 9/20/2024.

While we believe the current period provides an opportune time for consideration of Palisade’s Short Duration Bond strategy, we recommend investors consider the Strategy as an active allocation and diversifier from traditional core fixed income, high yield, or less liquid fixed income investments. Palisade’s Short Duration Bond strategy holds larger, publicly traded issues. If history is a guide, any weakness in credit markets could benefit the Strategy as investors tend to shorten duration and corporations attempt to opportunistically buy back bond issues that are next to mature.

As shown in the table below, Palisade’s Short Duration Bond strategy has generated strong returns with lower risk (standard deviation), along with strong Sharpe and Alpha ratios relative to traditional core fixed income and high yield.

STATISTICS (2/29/2016 - 8/31/2024)	Annualized				Upside Capture	Downside Capture
	Return	Standard Deviation	Sharpe Ratio	Alpha		
Short Duration Bond Composite (Gross)	5.63%	4.59%	0.81%	-	-	-
Bloomberg Barclays U.S. Aggregate	1.49%	5.19%	-0.08%	5.31%	59.65%	-13.07%
Bloomberg Barclays U.S. Agg. Corp. High Yield	6.59%	7.76%	0.60%	2.52%	45.67%	36.14%

Source: FactSet Research Systems, Inc.

Palisade’s Short Duration Bond strategy deploys capital in short duration debt instruments priced between 90% to 106% of par value. This subset of the convertible bond market may mitigate interest rate risk by focusing on the shortest dated bonds. From a credit perspective, companies prepare for maturing bonds over a year in advance by raising new debt or equity capital. This can limit the credit risk of these bonds for investors. Companies may also buy back their shortest dated bonds in a tender or through open market purchases which can put a floor on the price of the bonds.

Finally, the advantage of these instruments is that they are convertible into the underlying equity of the issuer. This “out of the money” call option is often overlooked, but if the issuer’s stock appreciates sufficiently, the Strategy can benefit by potentially selling the bonds above par value. These bonds effectively act like straight debt with similar yield and spread dynamics – except when the issuer’s stock price rises, at which point the fixed income securities could exhibit some equity-like upside. This potential equity upside, which plays no role in the security selection, can provide additional return, which is a key differentiating feature from other debt strategies.

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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.

Investing in securities involves risk, including the risk the entire amount invested may be lost. Securities investments are not guaranteed. Fixed income securities are generally subject to interest rate risks. 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. 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 that 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.

The Short Duration Bond Composite includes all tax-exempt portfolios invested in convertible bonds which meet the following criteria: a maturity or put date within 3 years or less from the date of purchase and priced between 90%-106% of par value at purchase. Accounts with zero commissions are included in the composite. There is no available industry benchmark that invests solely in convertible bonds meeting these criteria; therefore no benchmark is being disclosed. Any account in the composite that has a cash flow withdrawal or deposit of 50% or greater of the assets of the account will be removed from the composite for that month and will be added back in the following month. The minimum account size for this composite is \$3 million. The investment management fee schedule for the composite is 0.60% on the first \$25 million, 0.55% on the next \$50 million, 0.50% on the next \$75 million, and 0.45% on the remainder. Actual investment advisory fees incurred by clients may vary. The Short Duration Bond Composite was created April 1, 2016 and the inception date is March 1, 2016. As of January 1, 2024, the Short Duration Convertible Bond Composite was renamed the Short Duration Bond Composite.

The Bloomberg U.S. Aggregate Bond Index covers the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities.

The Bloomberg U.S. Corporate High Yield Index covers the USD-denominated, non-investment grade, fixed-rate, taxable corporate bond market.

The statistics reflect the Composite characteristics (gross of fees) and the indices as of the date shown. The Since Inception Risk statistics provided are not related to or indicative of either the Composite's or the indices' performance.

Alpha is a measure of performance on a risk-adjusted basis. Alpha takes the volatility (price risk) of the Strategy and compares its risk-adjusted performance to a benchmark index. The excess return of the Strategy relative to the return of the benchmark index is the Strategy's alpha.

Annualized standard deviation is a measure of the dispersion of a set of data from its mean – a measure of the variability of returns. The higher the standard deviation, the greater the range of performance (i.e., volatility). Standard deviation is calculated as the square root of variance.

The Sharpe Ratio is calculated using standard deviation and excess return to determine reward per unit of risk. The higher the Sharpe Ratio, the better the portfolio's historical risk-adjusted performance.

The Downside Capture percentage measures a manager's performance in down markets relative to a particular benchmark. A down market is one in which the market's quarterly (or monthly) return is less than zero. For example, a downside capture percentage of 50% means the portfolio's value fell half as much as its benchmark index during the benchmark's negative quarters. A downside capture percentage of less than 100% indicates a manager who outperforms the relative benchmark in the benchmark's negative quarters.

The Upside Capture percentage is a measure of a manager's performance in up markets relative to a particular benchmark. An up market is one in which the market's quarterly (or monthly) return is greater than or equal to zero. For example, an upside capture percentage of 50% means the portfolio's value increased half as much as its benchmark index during the benchmark's positive quarters. An upside capture percentage of more than 100% indicates a manager who outperforms the relative benchmark in the benchmark's positive quarters.

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