



**Palisade Capital Management, L.L.C.**

**Convertible Securities:  
A Misunderstood Asset Class  
September 21, 2010**

**Palisade Capital Management, L.L.C.**

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## *Why Invest In Convertible Securities?*

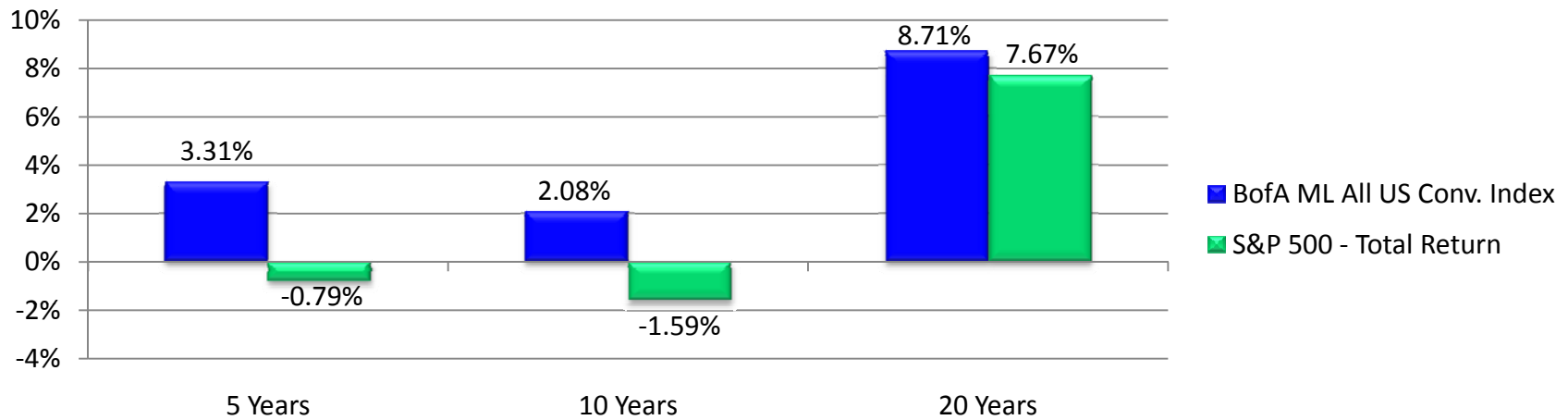
- Equity-like returns with less risk than common stock
- Risk/Reward profile is superior to straight equity on a total return basis
- Low correlation to other asset classes provides diversification benefits
- Senior standing in capital structure versus owning common stock
- Cross over buyers reduce convertible volatility



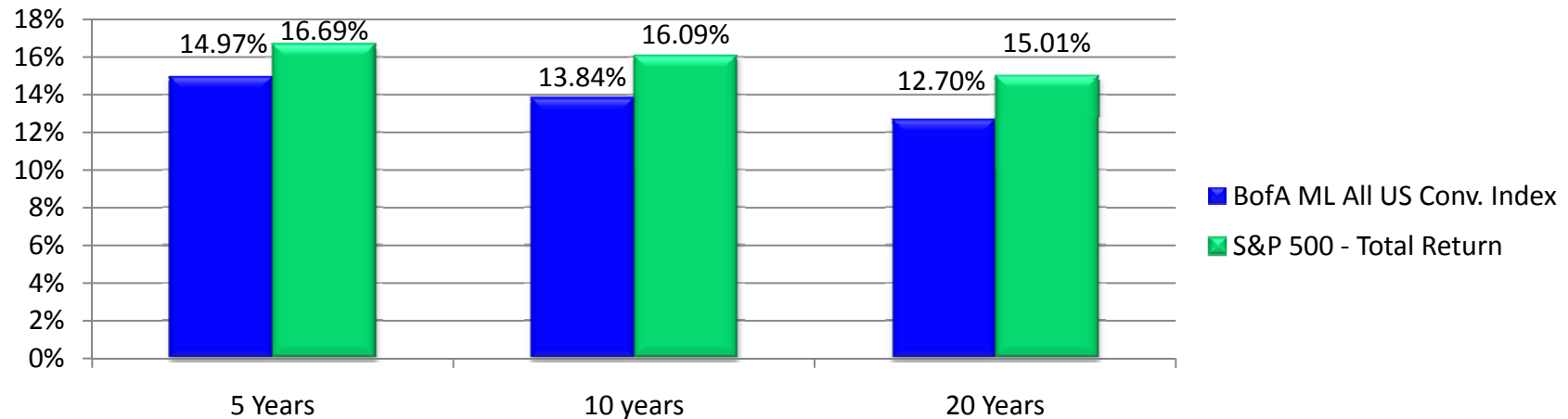
# Competitive Returns Compared With Common Stock With Less Risk

As of June 30, 2010

### Annualized Returns

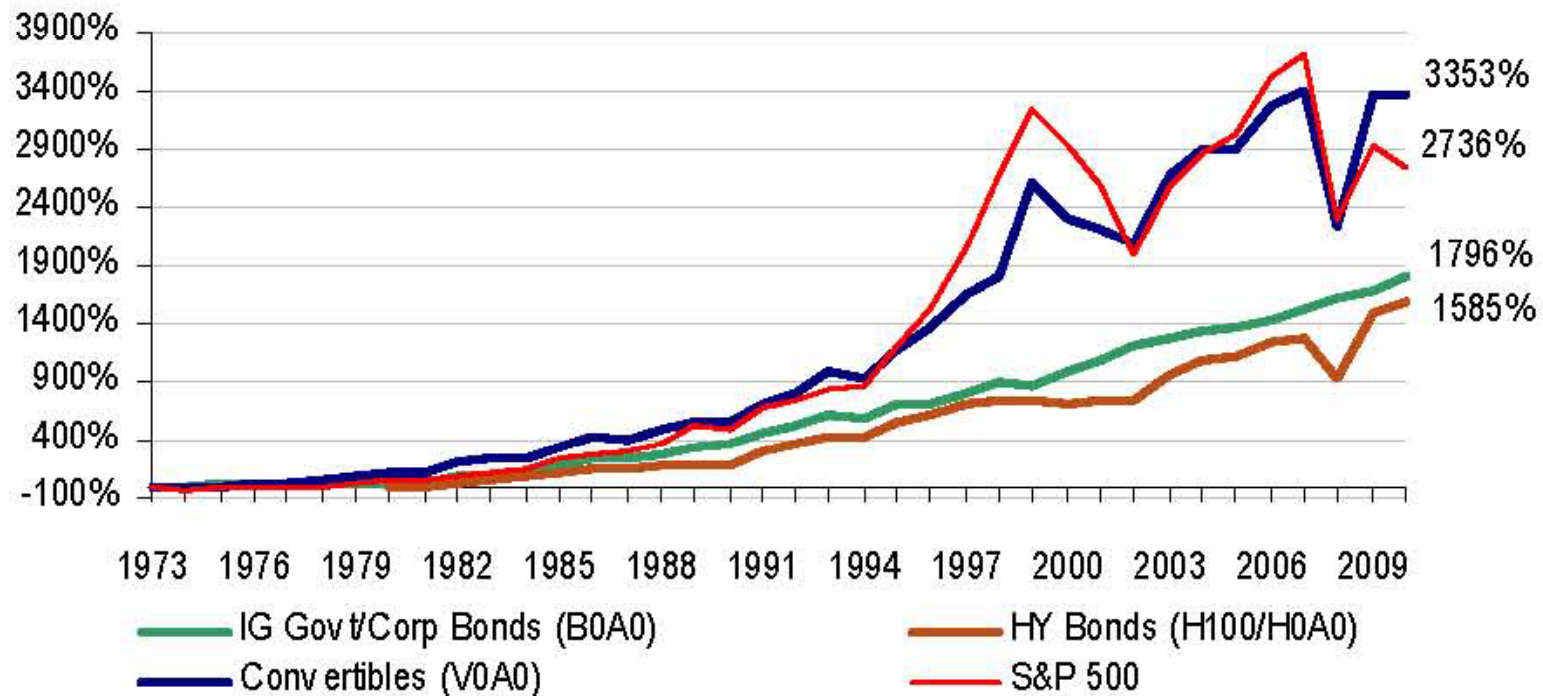


### Annualized Standard Deviation



# Convertibles Exhibit Equity-like Returns

Chart 3: Cumulative total returns (12/72 -06/10)



Source: BofA Merrill Lynch Convertible Research. Represents cumulative total returns.



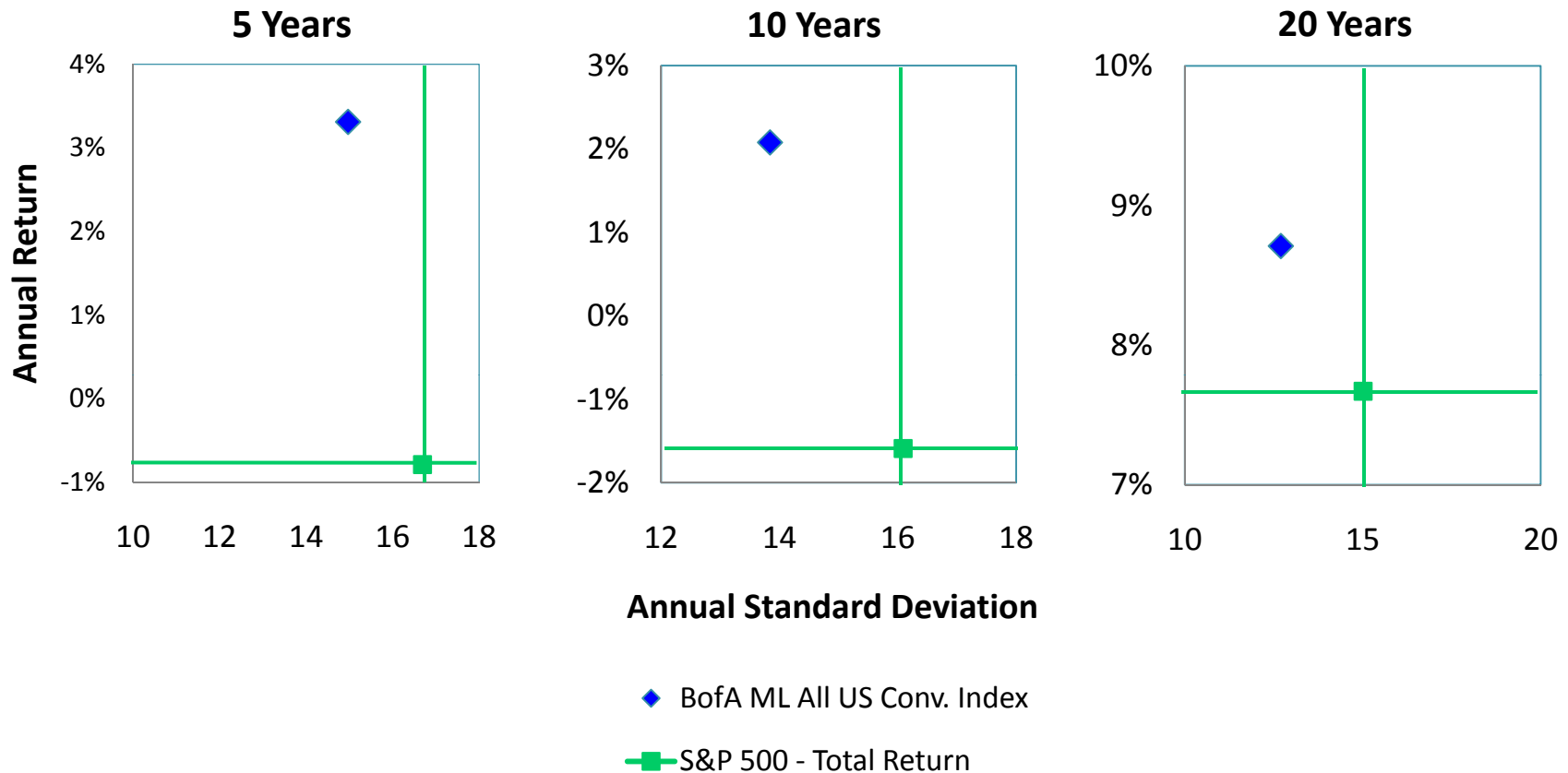
# Drivers of Convertible Performance

<i>As of August 31, 2010</i>	Current	Positive/Negative
Spreads	693	Positive
VIX	26.05	Positive
Cheapness	1.32%	Neutral



# Superior Risk/Reward Profile

As of June 30, 2010



- Convertibles delivered returns that were greater than common stocks over 5, 10 and 20 year periods.
- Volatility as measured by standard deviation was lower.



# Correlation Matrix of Various Asset Classes

Convertible securities' low correlation to other asset classes may provide diversification when used in a fixed income portfolio.

20 Years Ending June 30, 2010

## Correlation Matrix

	Barclays Capital Aggregate Bond Index	BofA Merrill Lynch All US Convertibles Index	Citigroup Treasury Bill 3 Month	S&P 500 Total Return Index	Barclays Capital Corporate BAA Index	Barclays Capital Corporate High Yield Index
Barclays Capital Aggregate Bond Index <sup>1</sup>	1.00					
BofA Merrill Lynch All US Convertibles Index <sup>2</sup>	0.15	1.00				
Citigroup Treasury Bill-3 Month <sup>3</sup>	0.11	0.00	1.00			
S&P 500 Total Return Index <sup>4</sup>	0.14	0.82	0.08	1.00		
Barclays Capital Corporate BAA Index <sup>5</sup>	0.80	0.49	-0.03	0.37	1.00	
Barclays Capital Corporate High Yield Index <sup>6</sup>	0.23	0.72	-0.09	0.58	0.64	1.00

Source: BNY Mellon Asset Services



# Convertibles – Then and Now

	Dec 31, 2008	Dec 31, 2009	June 30, 2010	YTD as of Sept 14, 2010
<b>Merrill Lynch Convert Index Performance</b>	-35.7%	+49.1%	-0.5%	7.0%
<b>S&amp;P</b>	-37.0%	+26.5%	-6.7%	2.0%
<b>Russell 2000</b>	-33.8%	+27.2%	-2.0%	4.7%
<b>NASDAQ 100</b>	-40.0%	+54.6%	-6.2%	4.2%
<b>Dow Jones Industrials</b>	-31.9%	+22.7%	-5.0%	3.0%

Source: BAS/ML Convertible Research, as of September 14, 2010.



# Convertibles – Then and Now

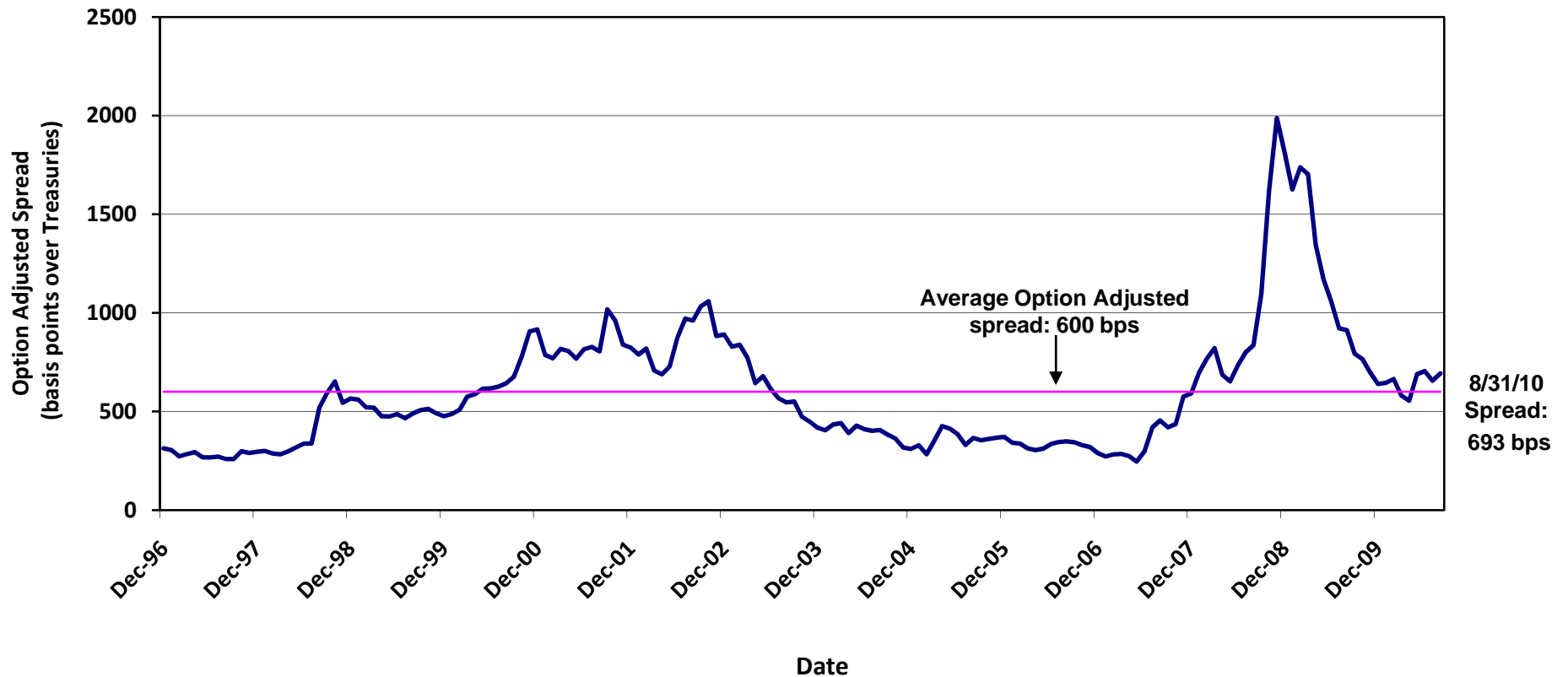
	Dec 31, 2007	Dec 31, 2008	Dec 31, 2009	June 30, 2010
US Convert Market Size	\$313 bln	\$177 bln	221 bln	\$212 bln
Current Yield	3.2%	5.6%	3.7%	3.8%
Percentage Cheap	0.07%	3.85%	1.13%	2.04%

Source: BAS/ML Convertible Research, as of June 30, 2010.



# Spreads Are Favorable For Convertibles

Option Adjusted Spread Over Treasuries for the Bank of America/Merrill Lynch High Yield Master II Index\*



\*The spreads for high yield bonds are for illustrative purposes only. These spreads are not option adjusted spreads for convertibles.

Source: Bank of America/Merrill Lynch High Yield Bond Research

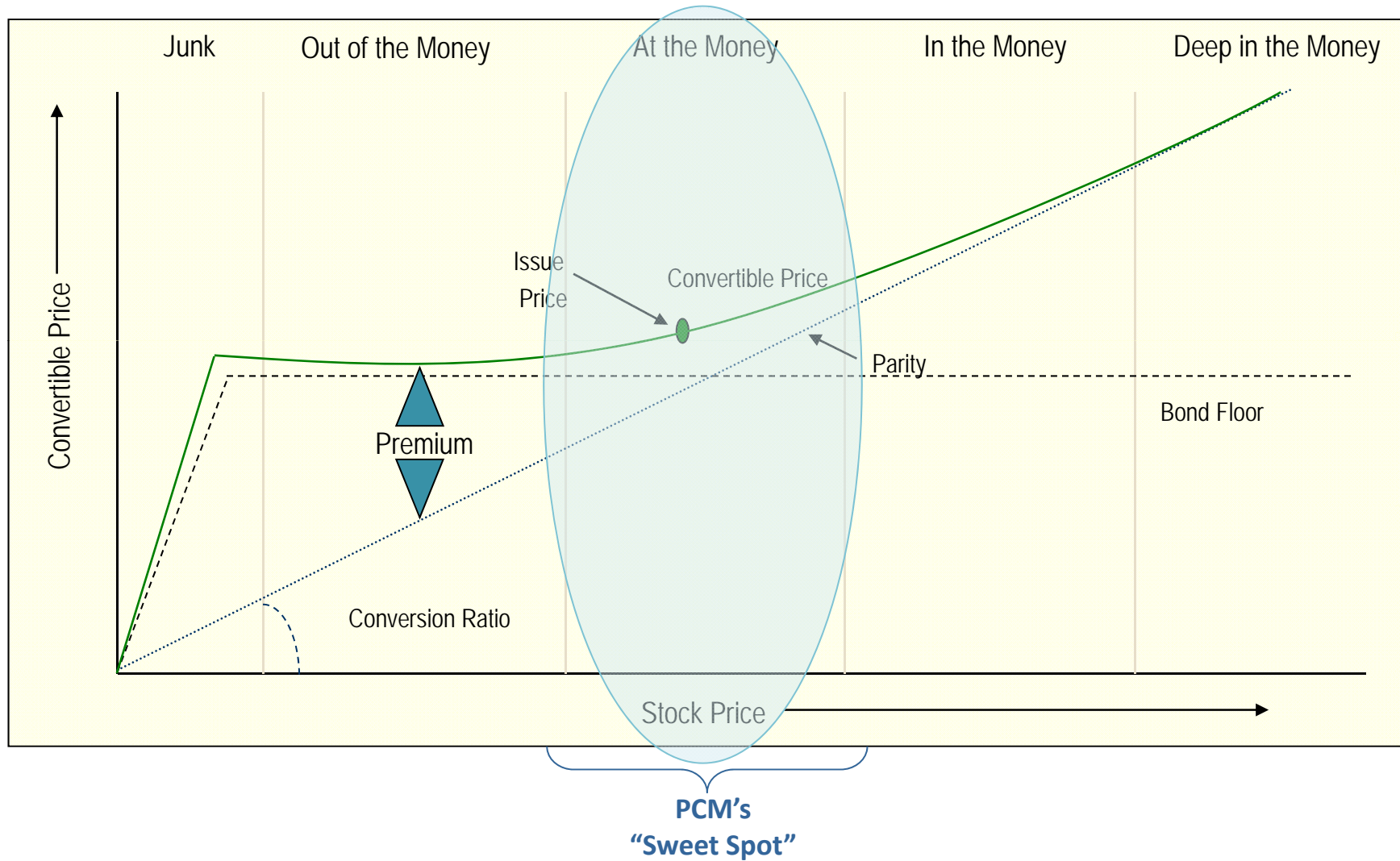


## *The New Issue Market Has Reopened*

- Many companies have raised funds via the convertibles market
  - Debt can be issued less expensively than a non-convertible
  - New issues in 2009 raised \$37.2 billion in proceeds
  - New issues for the first half of 2010 have raised \$14B
- New convertibles are usually priced at a discount to their fair value
  - Often trade at a premium to par on the first trading day
- Re-emergence of new issue calendar could further benefit speculative convertibles



# Convertible Payoff Profile



The "Sweet Spot" is in the price range \$80 to \$120 for a convertible bond. In this area, the convertible security has the maximum favorable equity participation or convexity. The convertible will appreciate to a greater degree during a rise in the stock than it will fall after a stock drop.



## *Why Invest In Convertible Securities Now?*

- Convertibles remain “cheap” relative to theoretical fair value
- Credit spreads continue to narrow
- Convertibles offer higher yield (income) than common stock
- The new issue market has reopened
- Companies have repaired their balance sheets by refinancing debt and issuing equity
- Cross over buyers reduce convertible volatility



# Footnotes

1. *The Barclays Capital Aggregate Bond Index covers the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities.*
2. *The BofA/ML All US Convertibles Index is a capitalization weighted index consisting of convertible securities designed to represent the universe of U.S. corporate convertible securities.*
3. *The Citigroup 3-Month T-Bill Index is an unmanaged index of three-month Treasury bills.*
4. *The S&P 500 Total Return Index is an unmanaged index that is widely recognized as an indicator of general market performance. The S&P 500 Total Return Index does not have a defined investment objective, unlike the other indices, nor does it charge fees and expenses.*
5. *The Barclays Capital Corporate BAA Index covers USD-denominated, investment-grade, fixed-rate, taxable securities sold by industrial, utility and financial issuers.*
6. *The Barclays Capital Corporate High Yield Index the covers the USD-denominated, non-investment grade, fixed-rate, taxable corporate bond market.*

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