



CONVERTIBLE SECURITIES

OVERVIEW

Convertible securities are often classified as fixed income instruments (bonds or preferred stocks), because they pay interest or dividends. However, convertibles are neither a pure fixed income, nor a pure equity security. The value of convertibles, while tied to the interest they pay, is also derived from their convertibility into common stock. With the right to convert, a holder has the opportunity to hold the security when it is not advantageous to convert, or to convert to common stock when it is not beneficial to hold the security. These features give convertibles upside potential with limited downside risk.

HISTORY AND INVESTMENT PHILOSOPHY

Combining attractive returns with traditionally lower risk, convertible securities have been integral to the prudent management of our clients' portfolios since 1994. Convertible securities often offer an attractive means to accumulate a significant position in a company's common stock without disturbing the market for the company's equity. Recognizing the clear value of convertible securities in their equity accounts, several of our clients proposed that we manage convertible portfolios. We readily accepted this mandate in 1994 and have evolved into one of the larger convertible managers in the industry.

PROCESS

Convertible investment ideas are initially generated at conferences, company presentations and through 'Street' research. For large capitalization companies, we base our evaluation on public documents, sell-side research reports, management meetings, conference calls and direct company contact. When we have an interest in a company, we meet with management at an on-site meeting. For all companies, we identify management's plans and objectives and evaluate their progress in meeting them.

After completing our due diligence, we establish a price target (percentage gain) and project the total return (capital appreciation and income) that we expect over a one-year holding period. Investment decisions are made by the Portfolio Manager together with Palisade's Investment Committee, which meets regularly to discuss investment opportunities. We then project the potential loss that would result if the stock fell by an amount equal to the projected gain. Generally, we look for convertible issues that will offer greater than 70% of the upside potential and less than 50% of the downside risk of the common stock equivalent.