SUPPLEMENT: OUR WAY FORWARD

A year ago, after the special distributions in the Limited Partnership and Capital Fund, we were carrying cash balances in excess of 15% of the value of these two funds. Believing that the weakness in oil would set up for a rebound and good investment returns beginning sometime in 2015, we had formulated a plan to deploy our cash balances and become fully invested in stages, commencing in the third quarter of 2014 and through the first two quarters of 2015. We took several steps and were on target to complete this process in May 2015. However during the second quarter of 2015 dark clouds reappeared and we reversed our course. We began selling energy securities in the second quarter and these moves have resulted in our cash balances rising back above 15% in the Limited Partnership and Capital Fund. We also reduced our exposure to certain energy companies in the Vantage Fund and in doing so raised our cash balances, albeit more modestly. The mandate of the Vantage Fund requires that we be more fully invested at all times. The securities that were sold were done so at significantly higher prices than where they were trading in late July. That decision looks good now. However, the balance of the energy portfolio, investments we felt best met our criteria, have also significantly declined over the same period, taking some of the joy out of our decision making. The return to what we consider to be high cash levels in the Limited Partnership and Capital Fund presented a new decision; do we redeploy the cash in these two funds or return it to our investors? For a variety of reasons that we will explain in this report, we have decided to return the cash to our investors.

The decision to distribute cash at this time ties to a larger decision with respect to the future of the Limited Partnership and Capital Fund. At our 2014 Annual Meeting in April 2015 we announced our plans; they included an orderly wind-down of the Limited Partnership and Capital Fund and the introduction of a new energy focused fund with the same mandate and guiding investment principles but using a more efficient mutual fund trust structure[1]. Although the exact timing of the launch of the new fund has not been determined it will likely occur sometime in the first half of 2016. We will handle the un-wind of the Limited Partnership and Capital Fund with a series of distributions and the current distribution should be seen as the first of several that will come in the next few quarters. No changes will take place with our Vantage Fund as it was initially set up using a mutual fund trust structure.

The Limited Partnership and Capital Fund were set up with, and maintain, a cornerstone philosophy of being a “partnership” with our clients. Implicit in this relationship from the get go was the notion that we would manage the money in the funds as best as we were able and, at some point, return the capital to our investors. A large number of Palisade investors have been with us since inception in 1998; a remarkable showing of faith and allegiance. We feel that the time is right, after 17 years, to honour our implicit arrangement with our longer term investors and to start putting the wind-up process in motion.

We have also been very fortunate to have had a number of quality investors join the Palisade “partnership” in recent years, with many expressing an interest in continuing to stay fully invested in the Palisade Funds. For those individuals who decide to remain invested in the new fund we will make the transition process as smooth and seamless as possible under existing securities regulations. The new fund, when it is launched, and others that might follow, will be managed with the same care and attention and “partnership” philosophy that have guiding Palisade for the past 17 plus years, but they will be driven by a younger investment team with longer time horizons than are perhaps practical for some of our original investors.

[1] This structure, not available to us when Palisade started, is more efficient allowing us to run one Fund that is qualified for both RRSP and non-registered investments and is most suitable in light of the increased regulatory and reporting requirements that have recently been imposed on our industry.

Palisade has a long history of distributions. We have always been sensitive to the changing demographics and risk tolerances of our investors and this is an important driver in our decision making. A special distribution in 2008 from the Limited Partnership and Capital Fund, and the concurrent establishment of the Vantage Fund, was designed to broaden our investment mandate and provide an alternative for investors wishing regular distributions. The 2014 special distributions in the Limited Partnership and Capital Fund provided an opportunity for our investors to recalibrate their exposure to our funds and energy in particular. At that time we spoke at length about the potential for black swans in the investment world, noting past experiences, including the very difficult 2008 credit crisis. However, to be clear, we did not anticipate the collapse in oil prices at the time of the distribution in 2014. What has followed has been a deeper sell-off than anything we would have imagined and, for energy investors, as damaging as the 2008 experience.

As was the case in the depths of the 2008-2009 financial crisis, we cannot know with certainty what the future holds for the energy sector. We believe we are in a “troughing” period for energy but do not know how long it will last, the shape of the recovery or, if things will get worse before they get better (not likely in our view, but something we must consider when charged with the mandate of managing other people’s money). We are managing our business through a very difficult environment and, as always, are looking to be prudent while also being positioned for a recovery. We believe we own a portfolio of investments that will stand the test of time and in all likelihood be worth more in the future than they are today.

There are several other reasons for doing the Limited Partnership and Capital Fund distributions sooner rather than later. We feel that it is not fair to our investors for us to sit on their cash if we are not planning to employ it within a reasonable period of time. Putting it in the hands of our investors gives them flexibility to make choices; this practice, while unconventional in the money/wealth management business, has been a guiding principle in our decision to make previous distributions. The distribution will allow our investors to breathe a bit easier with their remaining exposure, providing them space to be patient, an investment course of action that we feel is best at this point in time. We see austere times in Alberta for the next few quarters as the knock-on effects of the energy slow-down work their way through the economy. In this regard we think returning some capital will be welcomed by many of our investors. Lastly, previous distributions have given our investors a chance to recalibrate their exposure to energy markets and equity markets as a whole. This current distribution is designed to do the same.

Revisiting the circumstance of the 2014 special distribution may be useful in providing clarity with respect to what this distribution represents and what it does not. Distributions are less a timing tool than a risk mitigation tactic for a “long only” fund such as ours. At the time of the 2014 distribution energy markets were positive and we were selling securities into a rapidly rising market. Our unit values increased in value approximately another 10% in the quarter following the distribution confirming that the distribution was not a short-term timing tool. Similarly, investors should not look at the current distribution as a “signal” of where we are in the market cycle for energy. To repeat, it is merely a risk mitigation tool, and one that is consistent with plans announced in April at our AGM, prior to the recent down-leg in the energy market.

As a result of our plans to do an orderly wind-up of the Limited Partnership and Capital Fund we will not be encouraging subscriptions in the Limited Partnership and Capital Fund with the current distribution. It is not prudent to take new subscriptions knowing that we have a relatively short time frame for those investments to perform. While we believe it is likely that many of our investments will increase in value over the course of the next couple of years the prime focus will be liquidating the remaining securities, a purpose that is not in-line with taking on new investment capital in these funds. Investors who would like us to continue to manage the proceeds from the current distributions are encouraged to consider our Vantage Fund. Investors wishing to maintain the same amount of exposure to a more energy centric fund will have the opportunity to invest in a new energy focused offering which we anticipate will be available concurrent with the next distribution.

Going forward, the Vantage Fund will be run in a very similar fashion to how it is managed today with decisions made by the Palisade investment committee. As we transition, the investment committee will become increasingly influenced by Matthew Joss, John McAleer and Carli Tyson with input from other members of the Palisade team. The new energy fund, which will have the same mandate as the current Limited Partnership and Capital Fund, will be managed largely by Matthew Joss and John McAleer.

In summary, we believe returning a portion of the capital in the Limited Partnership and Capital Fund now is most consistent with our corporate plans and the most prudent course of action from a risk mitigation standpoint

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Why did we change course in the second quarter of 2015 and begin selling energy? New facts emerged that pointed to a much more challenging environment than expected earlier in the year. Our Alberta investments faced an increased probability of policy mistakes from the recently elected provincial government. The new government moved quickly to increase personal and corporate tax rates and increase carbon emission levies. Reviews of provincial royalties as well as further environmental and regulatory actions are planned. Risks are also appearing on the Federal stage; current polls point to a tight election race and a vote on October 19th. Opposition parties have proposed new regulations on banking fee income, among other “less than friendly” business initiatives. These new political challenges are taking place at the same time the Canadian economy is dealing with recessionary-like economic data. The timing could not be more unfortunate.

A global economic slowdown is taking hold, reflected not only in energy prices but a whole series of base metal and industrial commodity prices, several of which are returning to prices not seen since 2009. Europe has been grappling with Greece and fears of contagion have held back a recovery there. China has been a growth engine for the world economy and recent data from that country is also causing some concern. For North American oil, inventories remain stubbornly high, partly driven by imports in the United States despite robust demand for refined products. On the international scene, Saudi Arabia is currently producing record amounts of crude oil. The oil market is also concerned about new volumes from Iran in the wake of the G6 deal to lift sanctions. Furthermore we can’t help but be aware that the broader equity markets have been up for six years- a long time relative to most bull market cycles. In 2015 stock market breadth has narrowed significantly, particularly so in Canada, leading some to conclude that the broader equity bull market is growing tired.

Despite all of these negatives, longer-term we absolutely believe that “the cure for low oil prices is low oil prices”. Inevitably the oil market surplus will rebalance to favour higher oil prices, lifting our portfolios along with it. Lack of new investment in oil-producing basins will invariably cause production declines to kick in and surplus inventories to be worked off. Long term the price of oil is very closely correlated to its finding and production costs and the current oil price is now well below these costs even after adjusting for substantial reductions in oilfield service costs in the future. In many cases energy share valuations are at, or below, the lows they visited in the 2008-09 crisis and we are seeing panic selling reminiscent of that period. A lot of the risks identified earlier in this report are already reflected in today’s stock prices.

While mitigating timing risks by doing a relatively small distribution, we also want our investors to be exposed to the potential upside of a turnaround. We believe the best way to do this is to keep what remaining securities we have for the time being, only making small changes at the margin, and to give our investments time to recover. A couple of quarters from now several of the issues mentioned earlier will have greater clarity. The federal election will have taken place, the Alberta royalty review will be completed, the Iranian deal will have either been approved or defeated by US Congress or perhaps the hard line Iranians, there will be more information on the production decline profile of US tight oil, and important mega-projects such as West Coast LNG will either be further advanced or stalled. All of these issues will have a meaningful impact on the energy investment landscape and we will have a new set of facts that will guide us in making decisions about the timing of further portfolio sales, capital distributions back to our holders, and the launch of the new fund.

The Limited Partnership and Capital Fund have materially outperformed the S&P/TSX Capped Energy Index ("Energy Index") over the last twelve months but this is cold comfort. At the time of writing, the Energy Index was at the lows of 2008 and down 47% since its peak in June of 2014. By any standard this has been an exceptionally difficult year. The current sell-off has turned in to a full-fledged rout. It is painful and frightening to be in markets like these. Although it may sound glib, sometimes the best thing to do is to ignore the stock quotes for a while, knowing we own sound investments, and let the panic run its course. We believe the probability for things to improve from here, coming out of very depressed cyclical lows, are better than they were in 2014 when many things were hitting new highs.

However we also know that projecting the timing and shape of this recovery is an unproductive exercise in "crystal ball gazing". As noted earlier, we will let the new facts, as they come in, be our guide.

In previous downturns we have reminded investors that our business practices allow us to "hang in" through downturns. We do not use leverage and have a stable investor base, and therefore we are not forced to sell in the panic phase of a downturn. We believe we own some of the very best entities in the energy space. We do not feel it prudent at all to give them up today. The rebound, when it comes, will likely be dramatic off-the-bottom because many investments are badly oversold. The two "P"s, patience and prudence, are foremost in our minds as we implement our plans and contemplate the future.

Palisade adheres to key principles that we have had in place since inception and that we will continue to adhere to in the future. These include:

1. Our clients' interests are always put first. In respect of every major corporate decision we make, we ask ourselves the simple question, "what is in the best interest of our clients";

2. Maintaining a "partnership" relationship between fund manager and investors. When we are making investment decisions for the portfolio, we are making decisions about our own money as well as our investors' money.

3. Palisade has a strong preference for capital distributions. While our industry does not often return capital because it impacts the value of a money management business, we believe it is very important to our business model and client relationships. We will wind-up the Limited Partnership and Capital Fund in a well-organized and measured way through staged distribution, returning investors' money as promised.

4. Palisade believes in providing investors with maximum choice, particularly when new initiatives are undertaken. Money management firms often change portfolio managers with little regard to previous relationships. We have a great deal of confidence in our people, but it is essential that investors are aware of any changes and "sign-on" in the form of new subscriptions in fund mandates which explicitly acknowledge those changes.

All of the steps we are currently undertaking have these cornerstone principles as our guide. We intend to reach out to all investors in the coming months to discuss our restructuring plans in more detail. If in the meantime you have questions regarding any of the above, as always, feel free to call us. We look forward to reporting to you in the future.