Palouse Capital Management, Inc.

INVESTMENT STRATEGY

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MARKET OVERVIEW

Stock indices were almost flat for the quarter, yet there was a lot of price movement during the quarter. This reflects a number of cross currents and conflicting developments which resulted in a higher than normal level of confusion and uncertainty among investors.

One of the biggest developments was the strength in the US dollar, which hit a 12 year high in comparison to the Euro. The European Central Bank embarked on its own version of Quantitative Easing (buying bonds) and European sovereign debt yields plummeted, in some cases to negative interest rates.

It is difficult to fathom paying someone to keep your money, but at the current time there is nearly $3 trillion of European sovereign debt trading at negative interest rates. This has the effect of making US Treasuries and other dollar denominated assets more attractive. A European investor who bought US Treasury debt in the last 6 months has not only earned more interest but also has benefited from the rise in the US dollar.

These fund flows have helped keep US rates down and the U.S. stock market up. The downside is that US exports to Europe and Japan have become more expensive and the profits earned by US companies overseas are being hurt by translating the profits earned in less valuable Euros into more expensive dollars.

This factor plus the reduced earnings from the energy sector (due to the collapse in energy prices) have caused earnings estimates for 2015 to drop significantly. In our prior letter we had estimated an 8% increase in profits for 2015, which was still lower than consensus earnings gains of +10%. Consensus earnings forecast for the S&P 500 index have come down recently to the +1% range.

The analysts may be too pessimistic, as the economy may bounce back later in the year as the effects of poor weather in much of the country recede (just like last year). However, since our expected returns from equities this year is heavily dependent on earnings growth, the probabilities of a more flat market have increased.

In contrast, equity markets in other developed countries have outperformed the U.S. market so far this year. Japan has had an aggressive QE (Quantitative Easing) in place; the ECB's QE is just starting up; and China's central bank has been easing its policy. Investors appear to be following the lead of the US and moving into regions embracing QE, since the U.S. experience showed a high correlation between QE and higher stock prices.

However, the U.S. QE program has ended, and the US Federal Reserve is likely to raise rates at some point this year, depending on how the economy performs. Given this uncertainty, and the levels of geopolitical risk, it is unlikely that Price/Earnings multiples will expand. As always, our focus is on identifying mispriced securities and exploiting market inefficiencies to the benefit of our clients.

STRATEGY FOCUS [1]

Equity & Fixed Income Strategies

Thanks to a strong February, the majority of the equity indices posted positive returns for the first quarter of 2015. Expectations were high at the start of March Madness; however, events transpired bringing negativity back to the markets.

For the quarter, the S&P 500® Index posted a positive return of 0.95 percent. The healthcare sector continued to be the best performer for this index, and was the only sector in this index to post a positive return for the month of March. In a reversal from last quarter and last year, the utilities sector under performed and had the distinction of being the worst performing sector for the quarter. And, as expected, the energy sector continued to drop.

Last year we saw a spate of retail mergers and acquisitions, and from the start of 2015, it looks like this pattern may continue. We have seen announced M&A activity with big pharma, healthcare and technology, to name a few. We are pleased to see this activity having a positive impact on many of our portfolios.

From a strategy standpoint, our Large Cap Value Strategy continued its strong performance from last year, out-pacing its benchmark index for the quarter. Our individual stock selection in the information technology, consumer discretionary and industrials sectors was the primary driver in our performance. This out performance also carried over into our Large Cap Value Total Return Strategy.

We have mentioned in the past that our philosophy focuses on identifying mispriced securities. Our Small/Mid Value (“SMV”) Strategy performance during the first quarter of 2015 is a reflection of this approach. Our SMV strategy well out paced its benchmark based on individual stock selection. Healthcare, information technology and materials were the primary contributors to the SMV strategy’s performance. We also experienced the positive impact of the previously mentioned M&A activity in this strategy.

Our Diversified Income Strategy performed in-line with the S&P 500, and out-paced the Russell 1000® Value Index. Performance was enhanced due to stock selection in financials and information technology. The fixed income markets again had a strong quarter, with the Barclay’s Aggregate Bond Index posting a positive return of 1.61 percent.

[1] PCM obtains all financial/performance data cited herein from Bloomberg, S&P Dow Jones Indices, and Russell Investments, as applicable.

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Palouse Capital Management, Inc., a boutique asset management firm, founded in 1994, providing active asset management nationally to high net worth individuals, foundations & endowments, corporations, and public funds. The firm's fundamental "value" philosophy is consistently applied across the core equity strategies; Large-Cap Value, Large-Cap Value Total Return and Small/Mid Value. The firm also offers a Diversified Income Strategy for those clients seeking income from diversified asset classes, which may include fixed income, equities, preferred stock, REITS, and other income producing securities.

