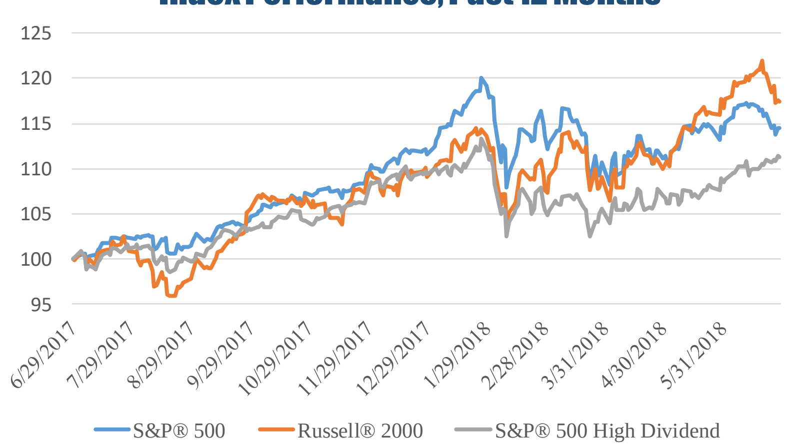
Palouse Capital Management, Inc.
Quarterly Commentary
July 2018

QUARTERLY RECAP

	Last Quarter	Previous Quarter	YTD	Past Twelve Months
S&P 500®	3.4%	-0.8%	2.6%	14.6%
S&P 500® Equal Weighted	2.8%	-1.0%	1.8%	12.3%
Russell 2000®	7.8%	-0.1%	7.7%	17.5%
S&P 500® High Dividend	5.4%	-3.5%	1.7%	11.3%
Consumer Discretionary	8.2%	3.1%	11.5%	24.3%
Consumer Staples	-1.5%	-7.1%	-8.5%	-3.7%
Energy	13.5%	-5.9%	6.8%	21.4%
Financials	-3.2%	-1.0%	-4.1%	9.6%
Health Care	3.1%	-1.2%	1.8%	7.0%
Industrials	-3.2%	-1.6%	-4.7%	6.2%
Technology	7.1%	3.5%	10.9%	31.2%
Materials	2.6%	-5.5%	-3.1%	10.4%
Telecom	-0.9%	-7.5%	-8.4%	1.7%
Utilities	3.7%	-3.3%	0.3%	3.3%
Real Estate	6.1%	-5.0%	0.8%	5.0%
Crude (WTI)	14.2%	7.5%	22.7%	65.0%
10 Year Treasury Rate	4.4%	13.9%	18.9%	26.2%
30 Year Treasury Rate	0.5%	8.5%	9.1%	6.2%
Dollar Index	4.8%	-2.1%	2.5%	-1.2%
Vix	-19.4%	80.9%	45.7%	40.6%

Index Performance, Past 12 Months



Market Recap

The S&P 500® Index ("SPX") returned 3.4% in the second quarter, a significant improvement over the previous quarter's negative result. SPX high dividend stocks returned 5.4% in 2Q18, also a marked improvement over the previous quarter. The best sector in the SPX was energy, which was up 13.5% on a 14.2% move in crude prices. The worst sector in the SPX in 2Q18 was industrials, which was down 3.2%. There were seven sectors up and four sectors down in 2Q18. Both the technology and consumer discretionary sectors continued on a nice run in the quarter; discretionary stocks and technology stocks are now up 11.5% and 10.9%, respectively, in the past six months.

The quarter was marked by the outperformance of small cap stocks. The Russell 2000® index returned 7.8% in 2Q18, well ahead of large cap stocks. One probable factor in this outperformance was the ongoing trade war, which heated up as the quarter progressed. Smaller cap companies are generally less international than larger cap stocks and therefore they might be less affected by tariffs than larger companies. That said, there are already pockets of domestic input cost inflation that are caused by tariffs – and that will affect many businesses regardless of size or geographic scope.

Overall, 1Q18 earnings (i.e. for the quarter ended March 31, 2018) were quite good. We calculate trailing annual earnings growth at about

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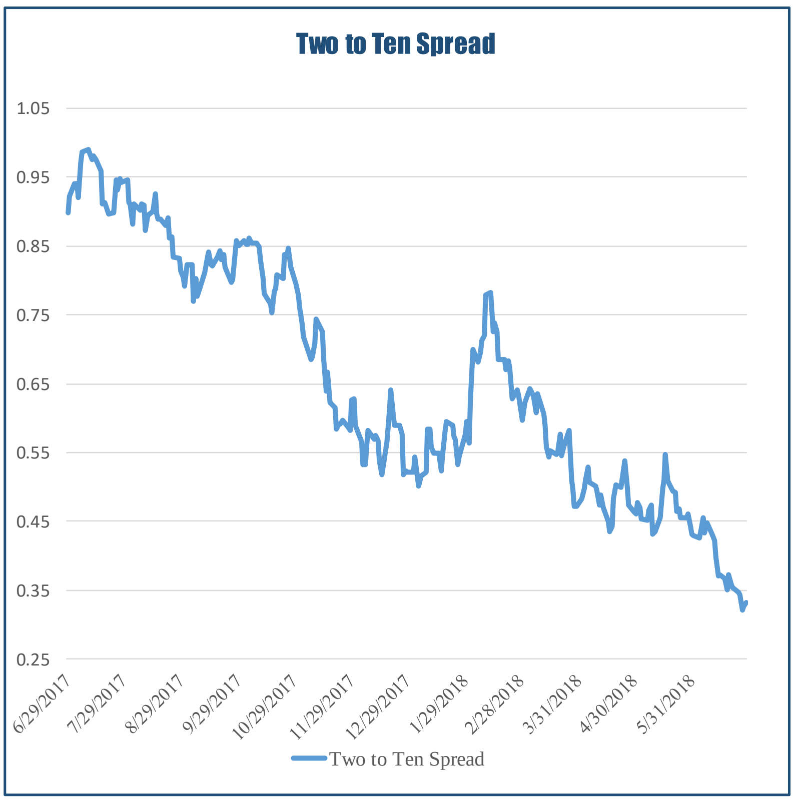
Source: Bloomberg. Past performance is not indicative of future results.



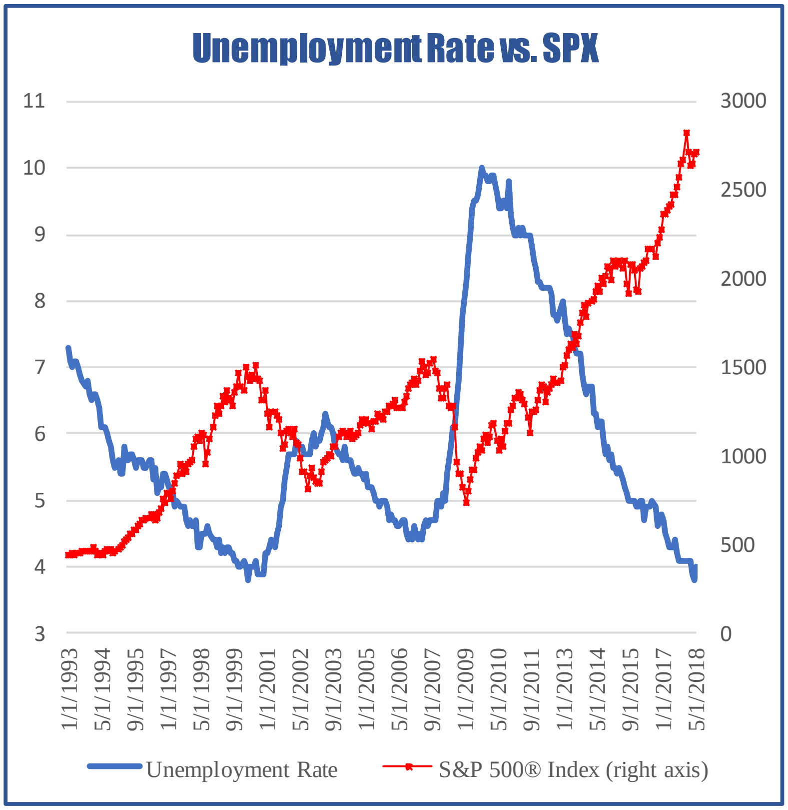
15% for the SPX. While at least some of the good earnings performance relates to tax reform, a very robust domestic economy continues to have a major effect.

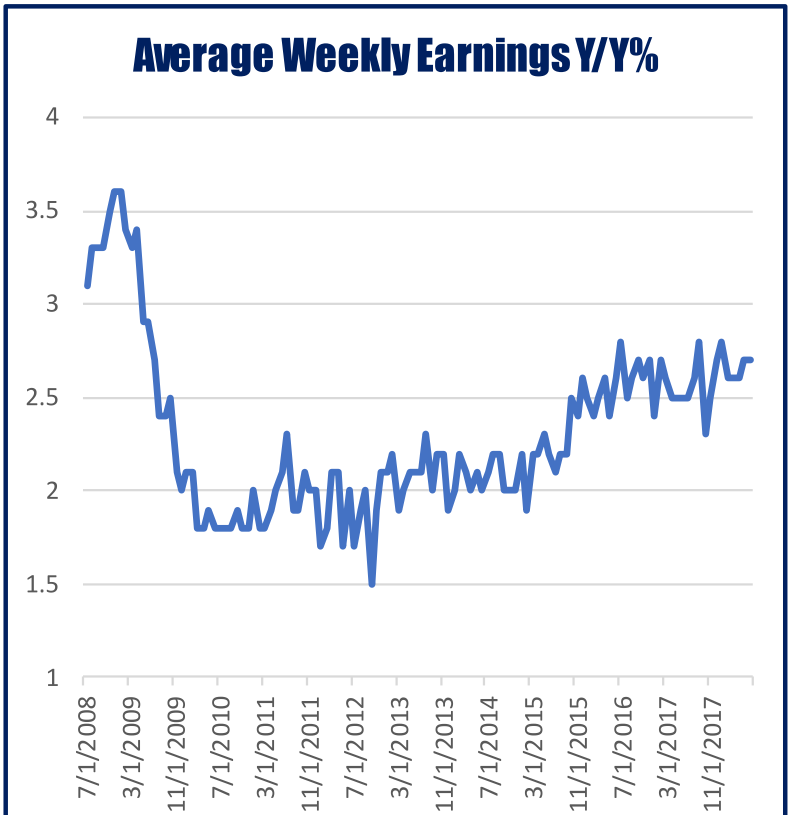
2Q18 seemed like a significantly less volatile quarter than 1Q18, and this was shown by the trend in the CBOE Volatility Index® ("VIX"). The VIX started the quarter at about 20 and dipped down to about 11.6 by early June. The VIX closed the quarter at 16.9, which is slightly above the long-term average for that series.

Macroeconomic Observations

The ten year treasury rate opened the quarter at about 2.73%, rose to just over 3% by mid-May and then fell back to about 2.8% by the end of the quarter; that sideways pattern is a change from the past couple of quarters, in which the ten year rate rose materially. The thirty year treasury rate was also flat during 2Q18. The two year treasury rate rose slightly during 2Q18, albeit at a slower rate than in recent quarters. The yield curve continued to flatten during the quarter; the two to ten spread is now approximately 30 basis points, down from one point at this time last year. We are watching the flattening of the yield curve with some concern because it could be a harbinger of an economic slowdown. The trough of the two to ten spread also corresponded fairly closely with the top of the past two bull markets.

The domestic labor market remained strong and continued to improve in 2Q18. As of June 30, 2018 the domestic unemployment rate was 4%, up slightly month over month. The unemployment rate is now about where it was at the low point back in 2000, which corresponded very closely to the top of a bull run. We wonder how much lower the unemployment rate can go, and we are beginning to see the negative impact of a very tight labor market in some industries.





We feel that the tightness of the labor market and tariffs will contribute to inflation, which ought to be a bad thing for equity markets at some point.

Market Model and Outlook

There is now 12% one year upside potential to the SPX based on our simple market model, down from 17.8% at the beginning of the quarter. Given that the return on the SPX was 3.75% during the quarter, the general level of target prices came in somewhat during the quarter. This was not a surprise because we felt that sell side target prices were generally set too high during 4Q17 earnings season, partially due to what we saw as somewhat bloated trading multiples at that time.

With the recent move in utilities and real estate stocks there is only 1.6% and 3.1% one year upside potential, respectively, for those two sectors. I would not expect those two upsides to change materially through earnings season and therefore it seems like these two sectors are running a little hot right now. We think financials are attractive right now; the softness in that sector has corresponded with the drop in interest rates and the narrowing of long term to short term spreads over the past six weeks or so. Industrials also look attractive, although we think the expected effect of tariffs will become clearer through the upcoming earnings season. We could see some significant guidance revisions in that sector in July and August.

The big market's forward P/E ratio started the quarter at about 16x and closed the quarter at about 16.6x; the market's forward P/E ratio therefore rose at a slightly higher rate than the return of the market. A multiple of 16.6x is higher than the long-term average, but it seems reasonable or attractive considering the market's robust earnings performance.

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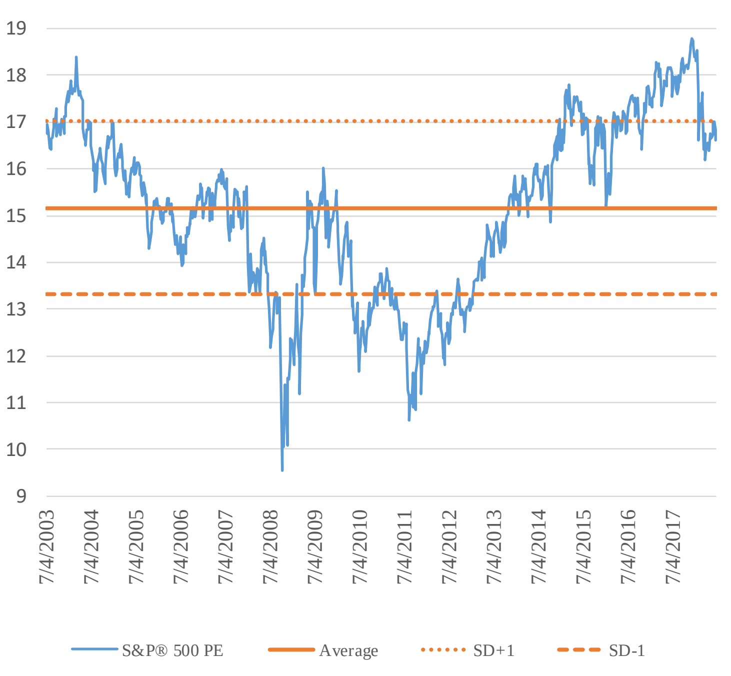
S&P 500® Forward P/E Ratio, Past Year

S&P 500® Bloomberg Forward P/E Ratio Past 15 Years



Weekly Report, Conference Call and Podcast

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Important Disclosures:

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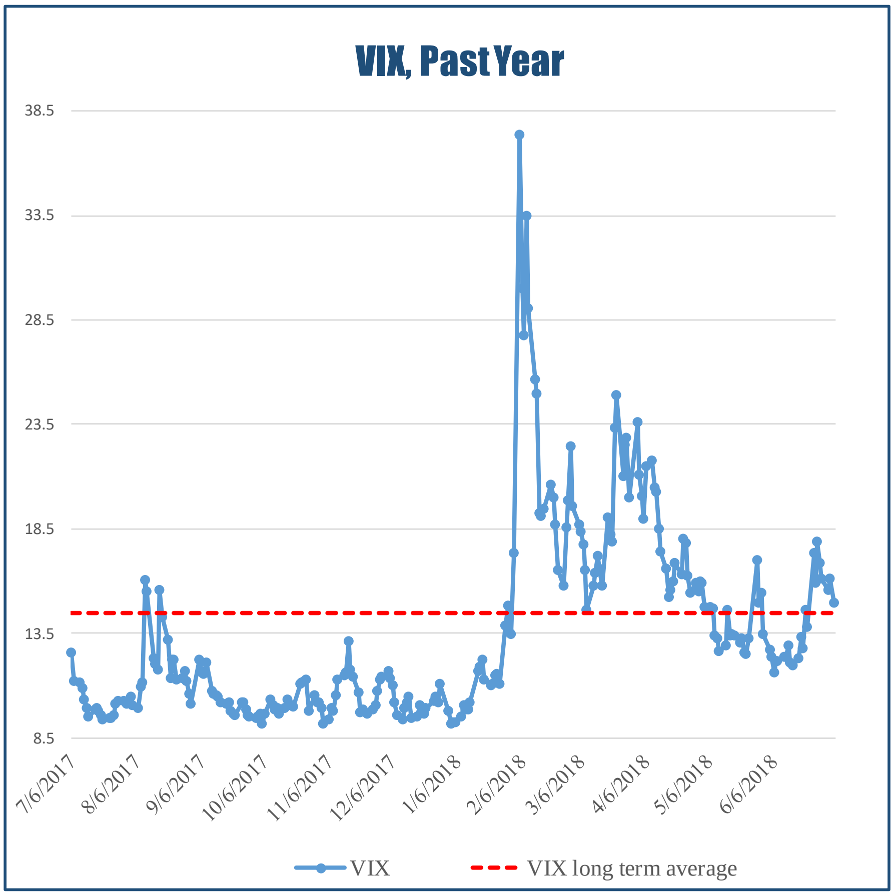
PCM Market Model

7/7/2018 10:39	Forward P/E	Price to Book Value	Upside to Target
S&P® 500 Index	**16.5**	**3.3**	**12.0%**
Consumer Discretionary	20.5	5.8	11.1%
Consumer Staples	17.5	5.0	8.1%
Energy	17.0	2.1	12.4%
Financials	12.2	1.5	18.0%
Health Care	15.6	4.1	11.0%
Industrials	15.9	4.6	16.9%
Information Technology	18.2	6.3	11.0%
Materials	15.5	2.6	16.5%
Telecommunications	10.4	1.9	12.0%
Utilities	17.1	1.9	1.6%
Real Estate	40.3	3.4	3.3%



from the individual performance attained for a specific client. The S&P 500 is a capitalization-weighted Index of the prices of common stock of the 500 leading companies representing the leading industries of the US economy, which are actively traded in the United States on the New York Stock Exchange or the NASDAQ. The Russell 2500 Value Index measures the performance of the small to mid-cap value segment of the US equity universe. It includes those Russell 2500 Index companies with lower price-to-book ratios and lower forecasted growth values. The source for all market data is Bloomberg, S&P Dow Jones Indices, and Russell Investments. Information regarding the services provided by PCM is available in Form ADV Part 2, which is available upon request or on PCM's website at www.palousecap.com.

If readers have any questions about anything mentioned in this report please feel free to contact us any time at 800-624-3833. Readers can also refer to our website, www.palousecap.com, for more information and can email PCM's Chief Investment Officer directly at bharman@palousecap.com with any questions. Readers should not assume that any investments in the securities mentioned in this program were or will be profitable or will continue to be held in the future. Pursuant to Rule 206(4)-1(a)(2)(A) we will provide a list of all trades made on behalf of clients in the past year upon request.

All data used to create this report was provided by Bloomberg.

"Market cap" means market capitalization.

"LCV" refers to PCM's Large Cap Value Strategy.

"TR" means our Large Cap Total Return Strategy.

"SMID" means Small to Mid Capitalization and also refers to our Small/Mid Cap Value Strategy in certain contexts.

"ACT" means our All Cap Tilt Strategy.

"SPX" and "the big market" refer to the universe of stocks in the Standard & Poors® 500 Index ("S&P® 500"). The Standard and Poor's 500 Index is a free-float capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic equity market. The S&P 500 equal weighted index is the equal weighted version of the SPX. The S&P High Dividend Yield Index measures the performance of 80 high dividend yield equities within the SPX.

The Russell 3000® Index is a float-adjusted, market capitalization weighted index comprised of equities of the 3000 largest domestic companies. The Russell 2500® index is a subset of the Russell 3000 index comprised of the 2500 smallest cap equities in the Russell 3000 and represents the SMID segment of the domestic equity market. The Russell® 2000 Index is a subset of the Russell 3000 index comprised of the 2000 smallest cap equities in the Russell 3000 index and represents the small cap segment of the domestic equity market.

The PCM Market Model examines forecasted earnings and average sell side target prices to arrive at market capitalization weighted average upside and trading multiples for the S&P® 500 index and all of its sectors. PCM does not use the actual S&P index weights to perform the calculations (i.e. we do not float adjust the model).

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