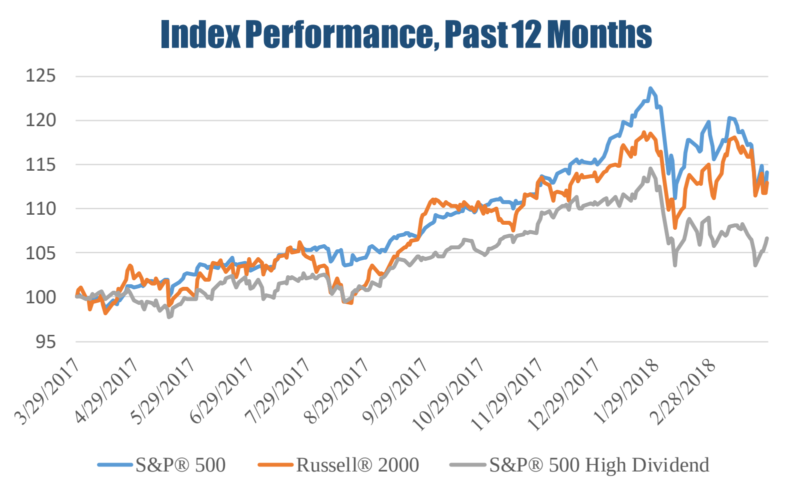
PALOUSE CAPITAL MANAGEMENT, INC.
Quarterly Commentary
April 2018

QUARTERLY RECAP

	Last Quarter	Previous Quarter	YTD	Past Twelve Months
S&P 500®	-0.8%	4.5%	-0.8%	14.1%
S&P 500® Equal Weighted	-1.0%	3.6%	-1.0%	11.8%
Russell 2000®	-0.1%	5.7%	-0.1%	13.0%
S&P 500® High Dividend	-3.5%	3.1%	-3.5%	6.7%
Consumer Discretionary	3.1%	0.8%	3.1%	17.3%
Consumer Staples	-7.1%	-1.3%	-7.1%	-1.4%
Energy	-5.9%	6.8%	-5.9%	-0.1%
Financials	-1.0%	5.2%	-1.0%	18.6%
Health Care	-1.2%	3.7%	-1.2%	11.0%
Industrials	-1.6%	4.2%	-1.6%	14.2%
Technology	0.6%	8.6%	3.5%	27.7%
Materials	-5.5%	6.0%	-5.5%	10.5%
Telecom	-7.5%	6.8%	-7.5%	-5.0%
Utilities	-3.3%	2.9%	-3.3%	1.5%
Real Estate	-5.0%	0.9%	-5.0%	2.4%
Crude (WTI)	-1.0%	12.2%	7.5%	31.2%
10 Year Treasury Rate	13.9%	1.3%	13.9%	15.2%
30 Year Treasury Rate	8.5%	0.9%	8.5%	-0.4%
Dollar Index	-2.1%	-2.7%	-2.1%	-9.8%
Vix	80.9%	-14.9%	80.9%	74.9%



Market Recap

The S&P 500® Index ("SPX") was off about 76 basis points in the first quarter of 2018 ("1Q18"). Small caps did a little better than that and high dividend stocks were off 3.5%. The best sector in the quarter was consumer discretionary, which was up over 3%. The worst sector in 1Q18 was telecommunications, which was off a nasty 7.5%. There were two sectors up and nine down during the quarter, indicating a broadly-based move.

The most notable features of the quarter were the increase in volatility and the correction. Through the end of January, the big market was up 7% on the year, continuing the strong trend that was in place for pretty much the entirety of 2017. The correction began on January 26, 2018 and the big market lost 10.1% between then and February 8, 2018. The SPX then rose 7.8% between February 8th and the end of that month, quickly erasing most of the correction. For the rest of the quarter the market was particularly volatile, although the SPX still closed higher than the low point reached in early February.

The SPX entered the year with a forward P/E ratio of about 18.5x, well above the long-term average plus one standard deviation. The combination of weakening prices and strong earnings resulted in a 10.3% drop in the SPX's forward P/E ratio (down to 16.8x) during 1Q18. While that feels like progress, the forward P/E is still higher than the long-term average of about 15x.

Overall, 1Q18 earnings were decent. We calculate annual earnings growth at about

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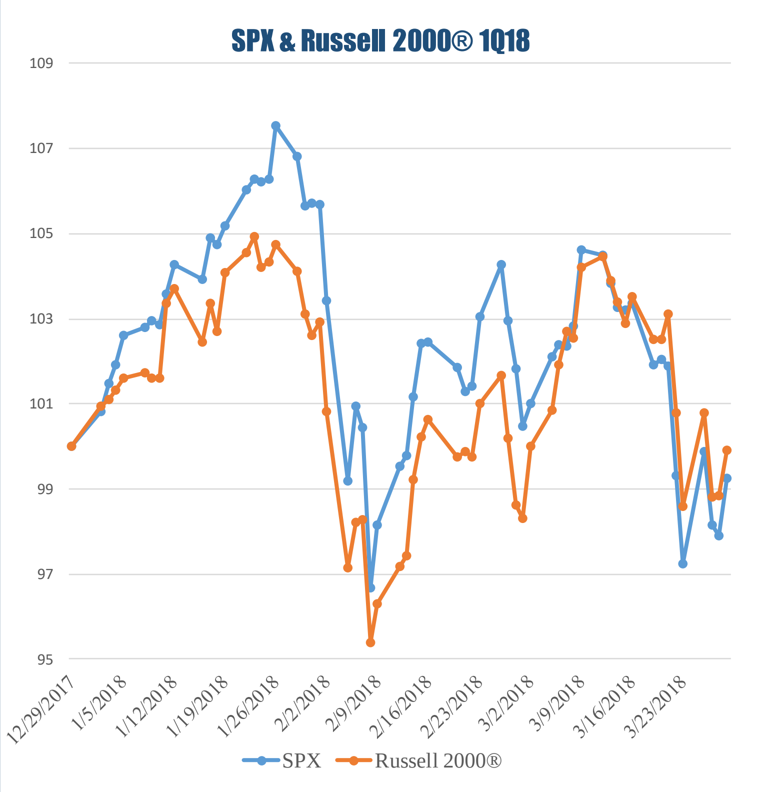
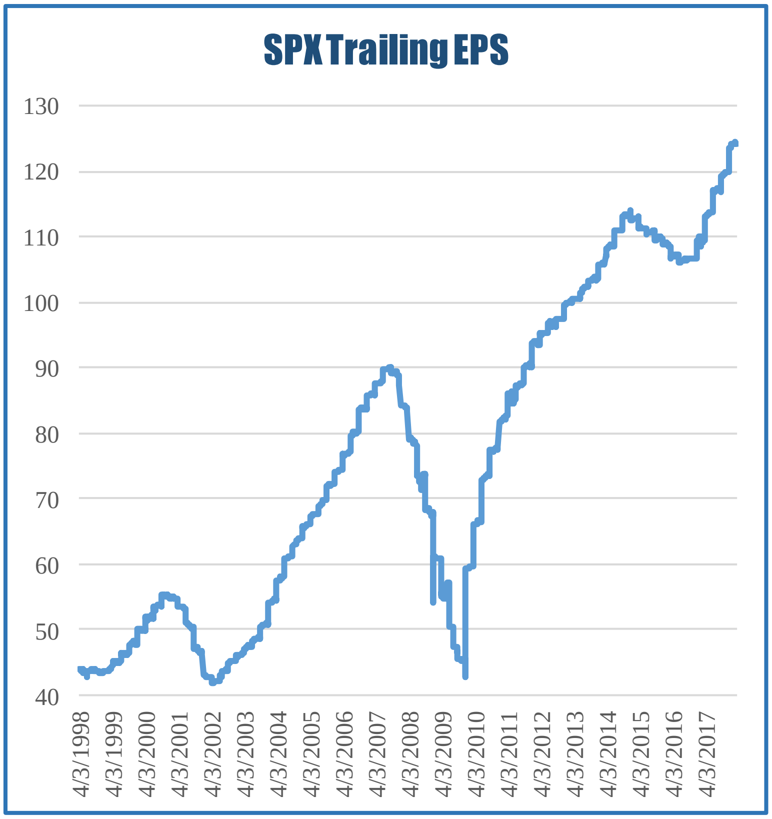
Source: Bloomberg. Past performance is not indicative of future results.





13.6%, which is a relatively strong number – and an encouraging one as we head into another earnings season.

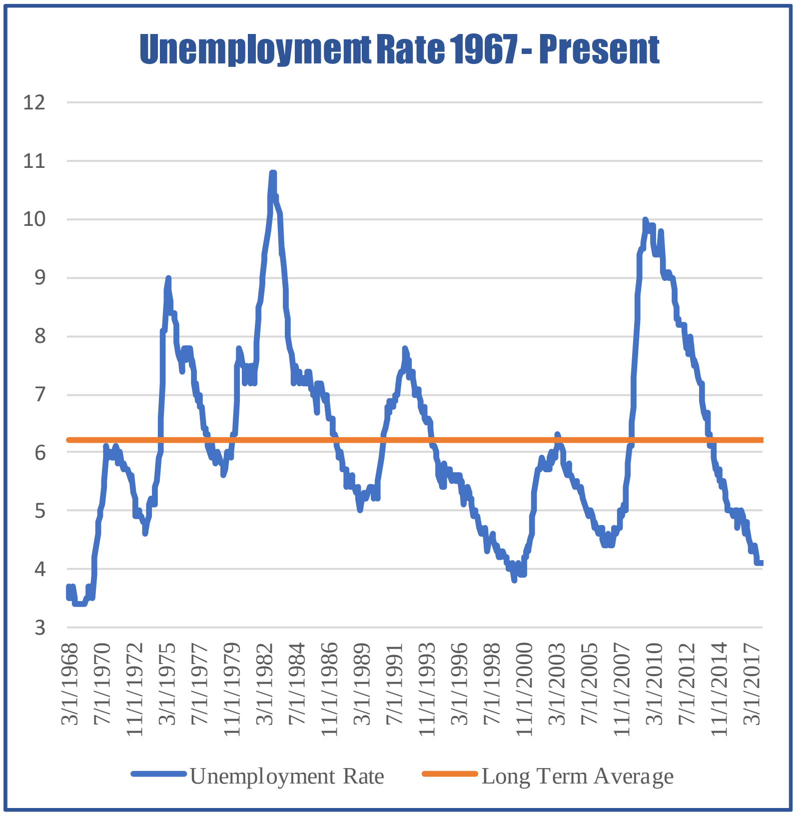
Macroeconomic Observations

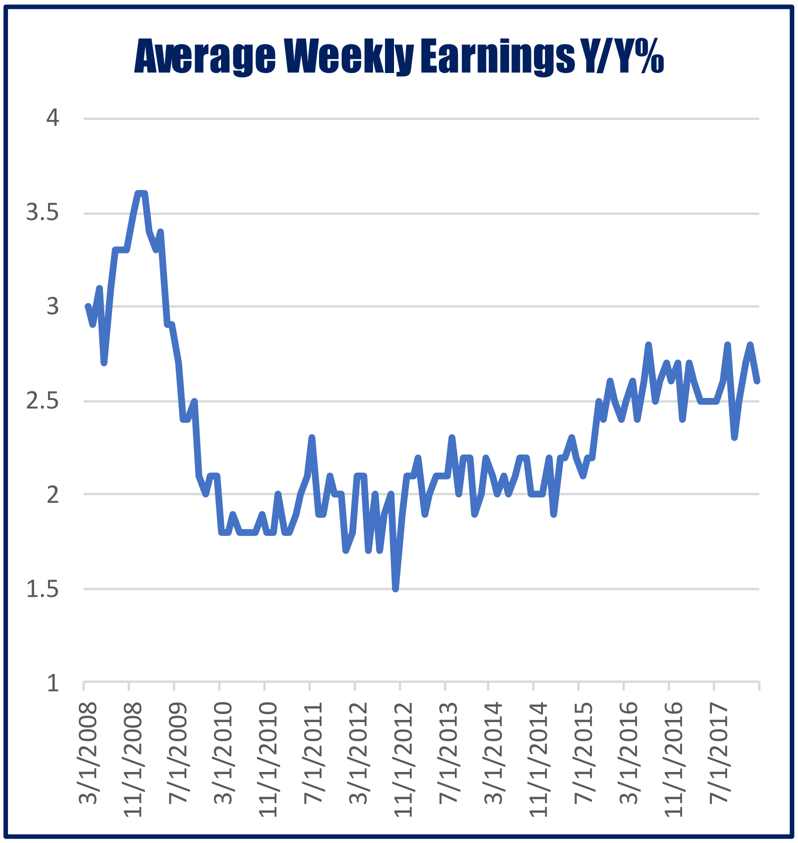
For much of the quarter, investors continued to focus on interest rates and inflation. This makes sense given the bull run is now over nine years old; investors seem to be watching for inflation to pick up, which could signal that the economy is in the latter stages of recovery. A pickup in inflation could also force the FED to raise short term rates at a pace faster than either the FED or the markets currently expect. Inflation and rising rates would have a significant effect on capital markets.

The ten year and thirty-year treasury rates rose slightly in 1Q18, although they are currently quite a bit lower than the highs reached at the beginning of February. Those changes to interest rates probably influenced at least some of the sector moves during the quarter - financials were one of the better performing sectors while utilities and real estate stocks were among the worst.

The two-year treasury rate has risen consistently, and at a faster rate than longer term rates, since last fall. The two to ten spread is now 47 basis points – the lowest figure in the past year. While the flattening of the yield curve abated for a while in the beginning of 2018, the spread has fallen significantly in the past couple of months. We continue to watch this development because the flattening of the yield curve *can* be an indicator of an economic slowdown.

The job market could be particularly influential on inflation. As of the end of February, the unemployment rate was 4.1%, about the same level as the low points reached during the last two cycles. Low unemployment might be starting to influence wage growth, which could be a prime inflation creator. Year-





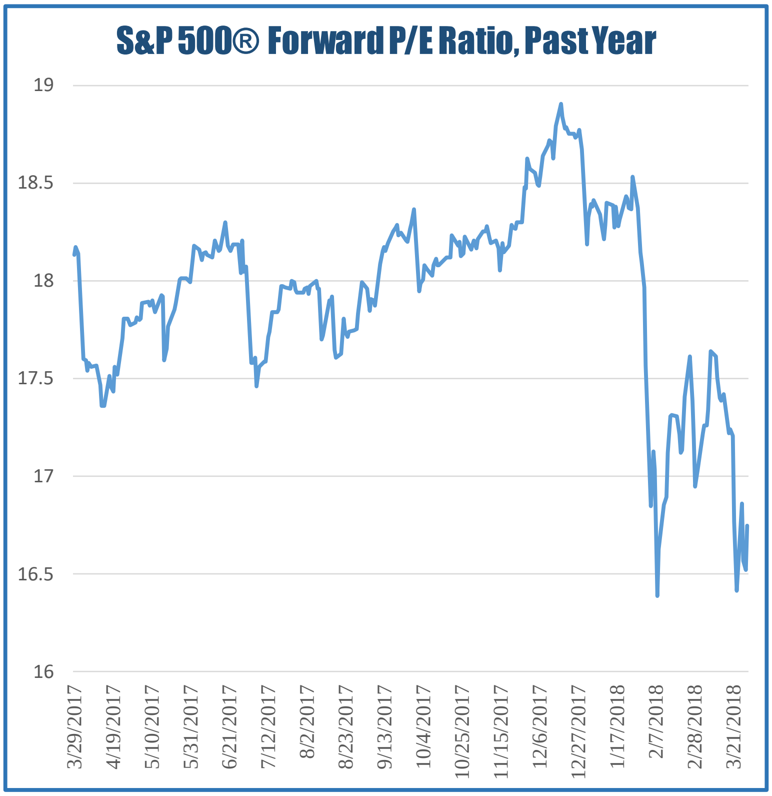
over-year wage growth was 2.6% in February, which is not a high number, yet the trend is a rising one. We do think that the labor force participation rate has room to fall, however, which could mean that unemployment could stabilize from here; that could indicate that the bull run could continue for a while.

Market Model and Outlook

There is now 17.8% overall one-year upside to the SPX based on our simple market model. That is a high number, but we point out that the upside is still being propped up by relatively high target prices and relatively high volatility. We think that target prices will come down during earnings season because they were last set at a time of higher trading multiples. Higher volatility ought to make for relatively high discount rates to target prices, at least in theory.

While this should be an interesting earnings season, we think that decent earnings growth will continue. We are not really seeing anything macroeconomically or anecdotally that would suggest otherwise. Entering an earnings season with better looking P/E multiples is also an interesting development.

That said, we think that relatively high volatility is here to stay. The market seems to be looking for reasons to sell off, and negative earnings surprises and negative guidance changes can be the strongest reasons for that to occur. We therefore think that markets could be rocky for at least a month or so. We think that technology stocks could be especially vulnerable right now given worries about data breaches, among other things. We also think that investors will be keenly looking for keywords about tariffs in upcoming management comments. Tariff news has been quite negative for stocks in recent weeks.



PCM Market Model

3/30/2018 10:57	Forward P/E	Price to Book Value	Upside to Target
S&P® 500 Index	**16.5**	**3.1**	**17.8%**
Consumer Discretionary	19.5	5.0	17.5%
Consumer Staples	17.3	4.4	16.1%
Energy	19.3	1.7	20.5%
Financials	13.3	1.4	15.8%
Health Care	15.2	3.9	19.9%
Industrials	16.8	4.5	16.3%
Information Technology	17.3	5.6	20.2%
Materials	15.7	2.7	19.1%
Telecommunications	10.6	2.1	16.0%
Utilities	16.0	2.8	5.7%
Real Estate	37.0	2.8	10.9%

Ex-Energy and Ex-Real Estate Forward P/E	**16.16**

SPX trailing P/E multiple	**21.27**

As value investors, we will take advantage of earnings-based weaknesses as long as it makes fundamental sense to do so. While higher volatility takes a strong stomach, it can create short term buying opportunities for long term investors.

Weekly Report, Conference Call and Podcast

Our clients are invited to receive our CIO's weekly podcast and weekly report. In addition, all clients are invited to participate in our weekly conference call. We provide these services to our clients free of charge and they are not available to non-clients. In the weekly report and the audio programs, Ken Roberts and Bryn Harman discuss market developments and trends that we observe in our week to week research efforts. Please contact Bryn Harman at bharman@palousecap.com for more information.

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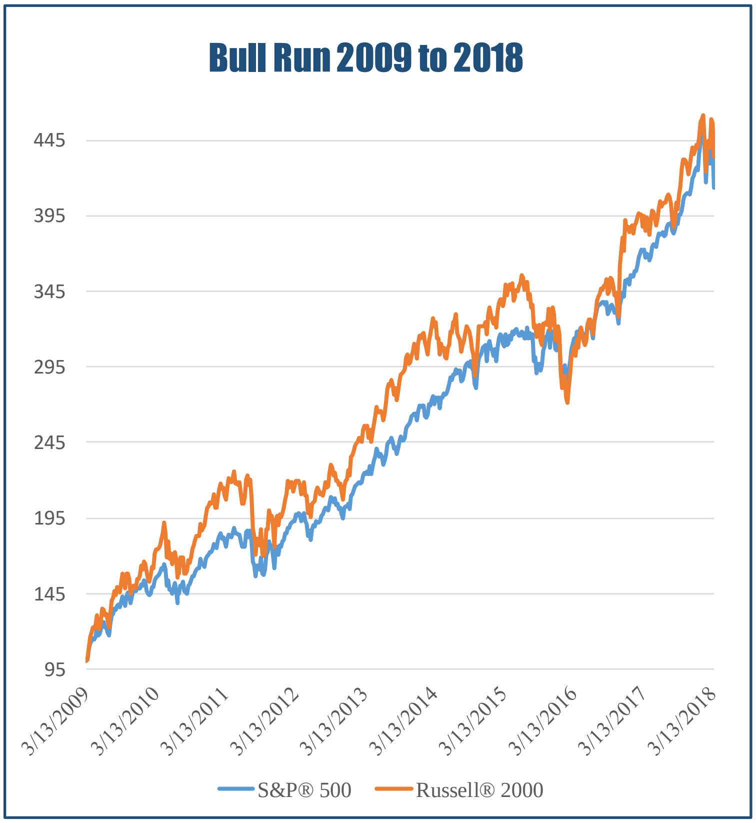

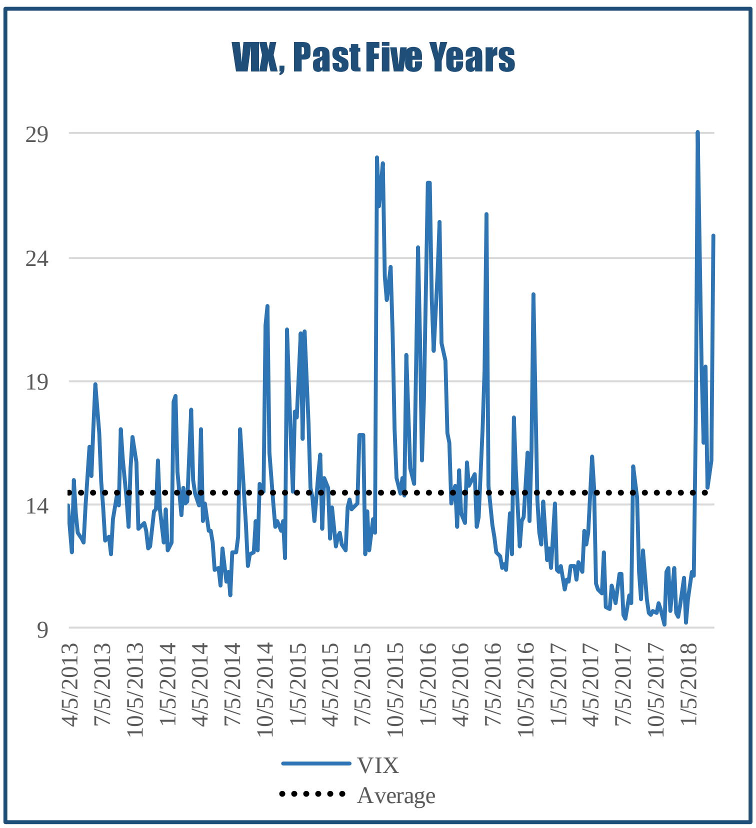

everyone. The income generated by the securities held in PCM's Large-Cap Value Total Return and Diversified Income strategies may decline. Generally, the prices of fixed income securities decline as interest rates rise. The Diversified Income Strategy may include investments in lower quality, higher yielding fixed income securities which may be subject to great price fluctuation than higher quality fixed income securities. Index returns and other historical data were gathered from resources believed to be reliable; PCM does not guarantee their accuracy. The performance of the indices may be materially different 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.

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