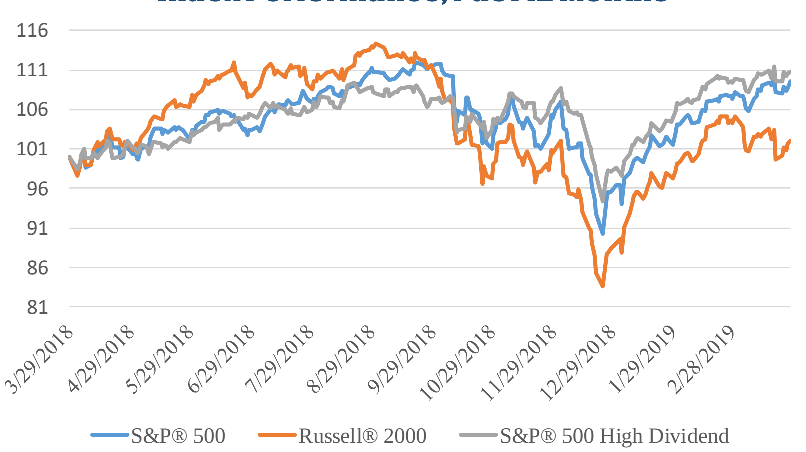
PALOUSE CAPITAL MANAGEMENT, INC.
Quarterly Commentary for 1Q19
April 2019

QUARTERLY RECAP

	Last Quarter	Previous Quarter	YTD	Past Twelve Months
S&P 500®	13.6%	-13.8%	13.6%	9.5%
S&P 500® Equal Weighted	14.9%	-13.9%	14.9%	7.2%
Russell 2000®	14.6%	-19.1%	14.6%	2.0%
S&P 500® High Dividend	12.2%	-8.1%	12.2%	10.7%
Consumer Discretionary	15.7%	-16.3%	15.7%	13.2%
Consumer Staples	12.0%	-5.2%	12.0%	10.5%
Energy	16.4%	-24.9%	16.4%	1.3%
Financials	8.6%	-13.4%	8.6%	-4.7%
Health Care	6.6%	-9.2%	6.6%	14.9%
Industrials	17.2%	-18.0%	17.2%	3.2%
Technology	19.9%	-17.7%	19.9%	15.4%
Materials	10.3%	-13.2%	10.3%	-0.4%
Telecom	14.0%	-13.1%	14.0%	7.8%
Utilities	10.8%	1.7%	10.8%	19.3%
Real Estate	17.5%	-3.0%	17.5%	21.0%
Crude (WTI)	32.4%	-39.7%	32.4%	-7.4%
10 Year Treasury Rate	-10.4%	-13.0%	-10.4%	-12.2%
30 Year Treasury Rate	-6.6%	-6.8%	-6.6%	-5.4%
Dollar Index	1.2%	0.9%	1.2%	7.9%
Vix	-46.1%	111.8%	-46.1%	-31.3%

Index Performance, Past 12 Months



Market Recap

Equity markets came roaring back in 1Q19 after correcting violently in 4Q18. While 4Q18 was the sixth worst quarter for the S&P 500® Index ("SPX") since 1988 (which is the extent of our data set), 1Q19 was the ninth best quarter in the same time frame. All eleven sectors were significantly positive in 1Q19 and the best sector during the quarter was technology. The worst sector last quarter was healthcare, and it was still up 6.6%[1]. Small caps outperformed large caps in 1Q19 while high dividend stocks lagged.

Hindsight is a wonderful thing, and now that we have historical data, we can assess the last market correction. Between September 20, 2018 and December 24, 2018 the SPX fell about 19%. Many investors consider a -20% move to be a bear market, not a correction, so I guess one could characterize the last correction as a "mini bear market" for large cap stocks. Small caps took it much worse than large caps; the Russell 2000® index ("RTY") was off about 27% between August 31, 2018 and Christmas Eve, 2018.

What happened after that was impressive; between Christmas Eve and the time of writing the SPX returned 23.3%. Small caps did better than large caps during that time – the RTY returned almost 25% over the same time frame.

Why did this happen? Readers who are familiar with my regular work will notice that I tend to frame market action in the context of fundamental valuation. Last September I noted

[1] All equity return figures include the effect of dividends unless otherwise stated.

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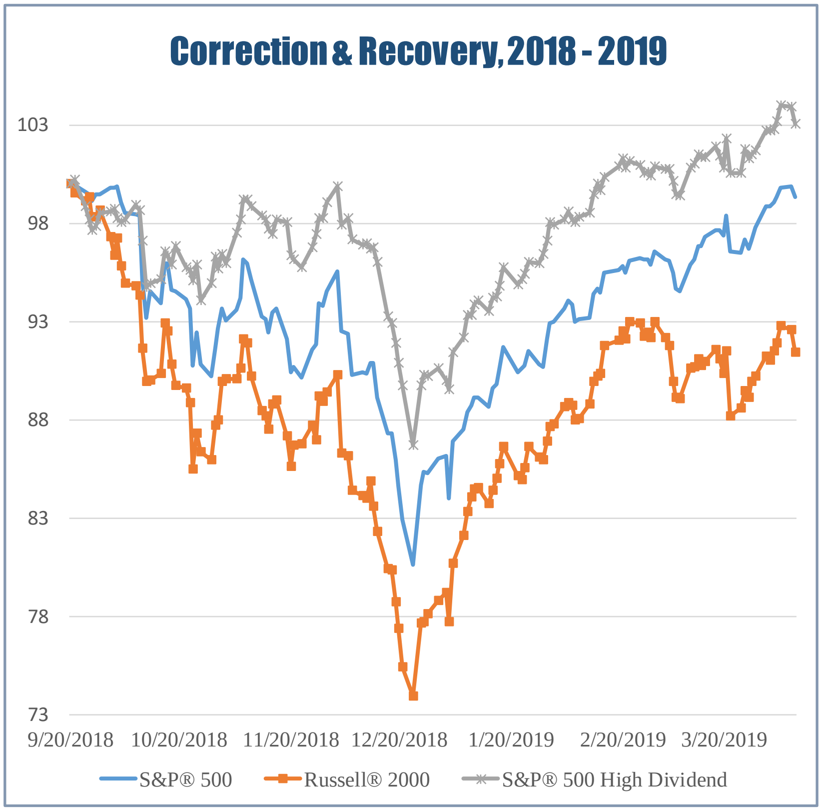
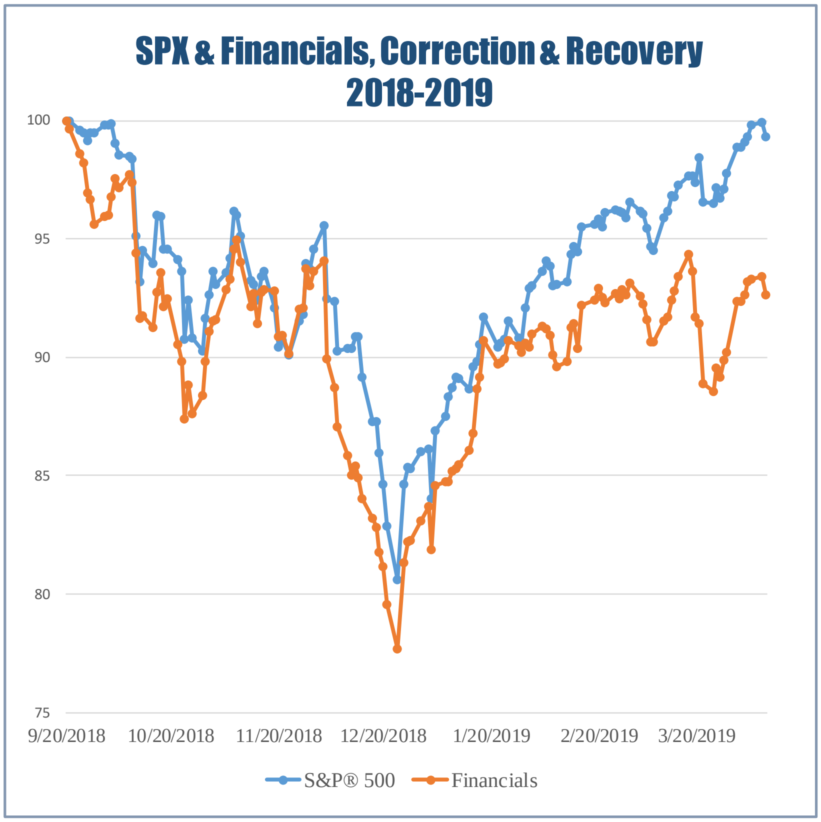
Source: Bloomberg. Past performance is not indicative of future results.

that a market forward P/E multiple above 17x was problematic, especially when there was a lot of talk about a pending recession and bear market at the time. I thought that there was a "decent chance" of a correction but that the market would recover from it rather than enter a bear phase. I admit that just before Christmas I was worried that the pain we were feeling was actually the beginning of a bear market. Thankfully, just as with the previous correction, the market came roaring back as we made our way through earnings season.

4Q18 earnings season was probably better than many investors and market watchers were expecting. Starting in about November last year the term "earnings recession" was being thrown around constantly as the market was putting up some really ugly days. It seems like many investors were expecting an earnings growth slowdown, if nothing else. The pressure this caused back in December was relieved in January and February as lots of earnings reports came in as expected or better. The last time I ran our earnings tracker model back in February, 70% of "4Q" earnings reports were positive surprises and the cap weighted average surprise was 4.7%; both of those figures are in line with what we had been seeing in the year prior.

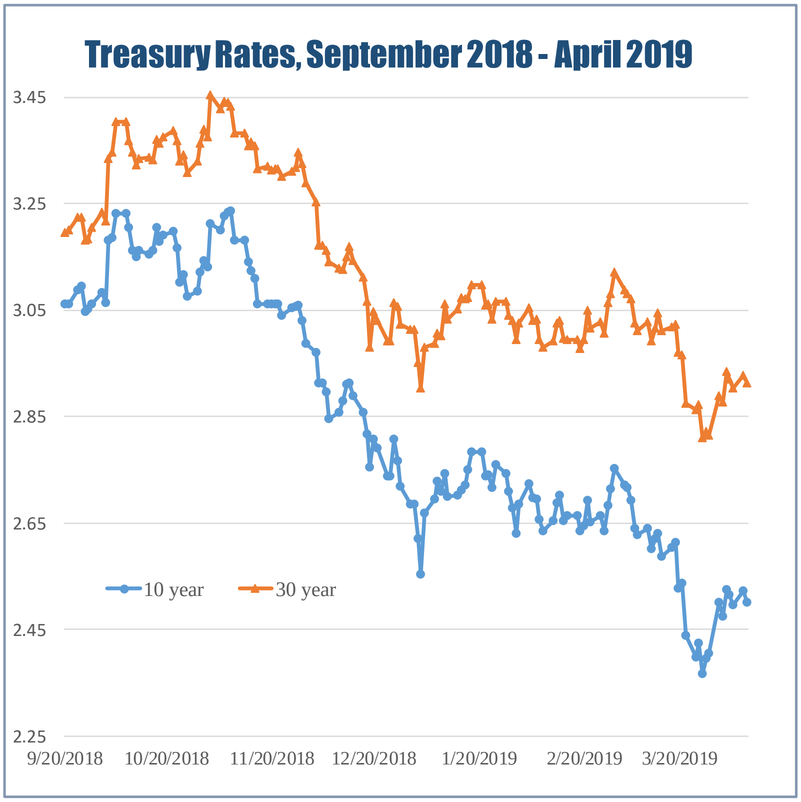


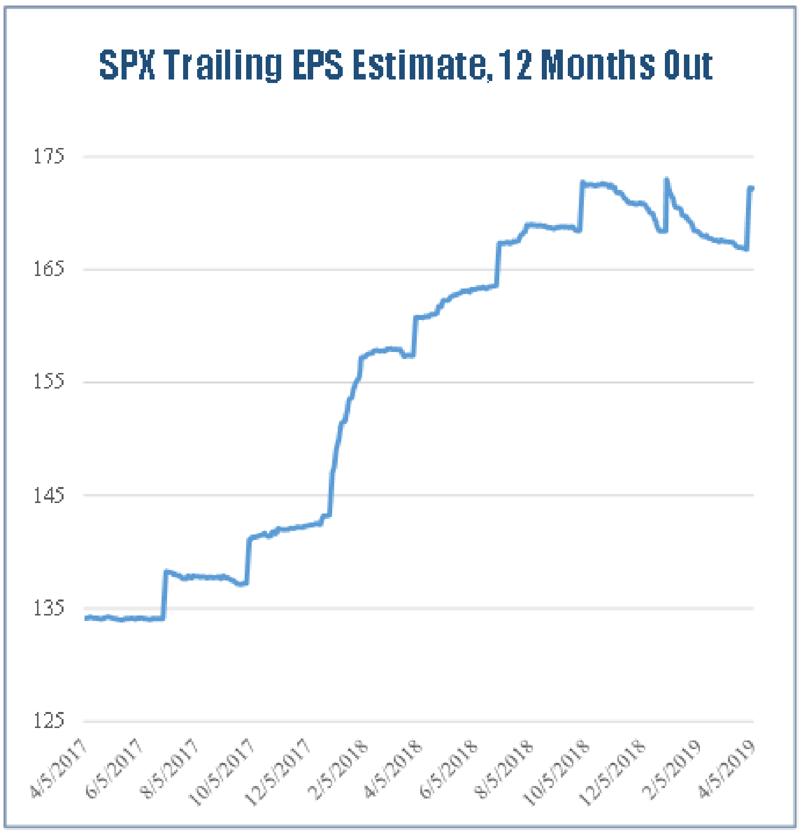


Market Model and Outlook

Our simple market model, which is based only on average sell side target prices, now suggests a 7.4% one year upside potential to the SPX, on the low side for this data set. There are now 120 SPX companies trading at prices that are higher than their average sell side target prices and 231 SPX companies (almost half the index) trading at less than 5% one year upside to their average sell side target prices.

The SPX's forward P/E multiple is now 16.8x and I note that the EPS figure used for calculating the





market's forward P/E multiple jumped last week as we entered a new quarter (which usually happens). Had that not been the case, the forward P/E multiple would be over 17x, and in a range that series has not liked to be in historically. I also note that the SPX's forward EPS figure has declined materially as we made our way through the past two earnings seasons. If that happens again this time (i.e. in 1Q19 earnings season that we just entered), then the forward P/E multiple will have to rise materially, other things being equal (or stock prices will have to come down).

I continue to think that the market is looking toppy on a fundamental basis right now, and 1Q19 earnings will have to be good to keep many stocks where they are. While we will be getting a new set of sell side opinions soon, the upsides still seem low right now. I am cautious about the equity market right now, but I am optimistic that we will get a decent earnings season.

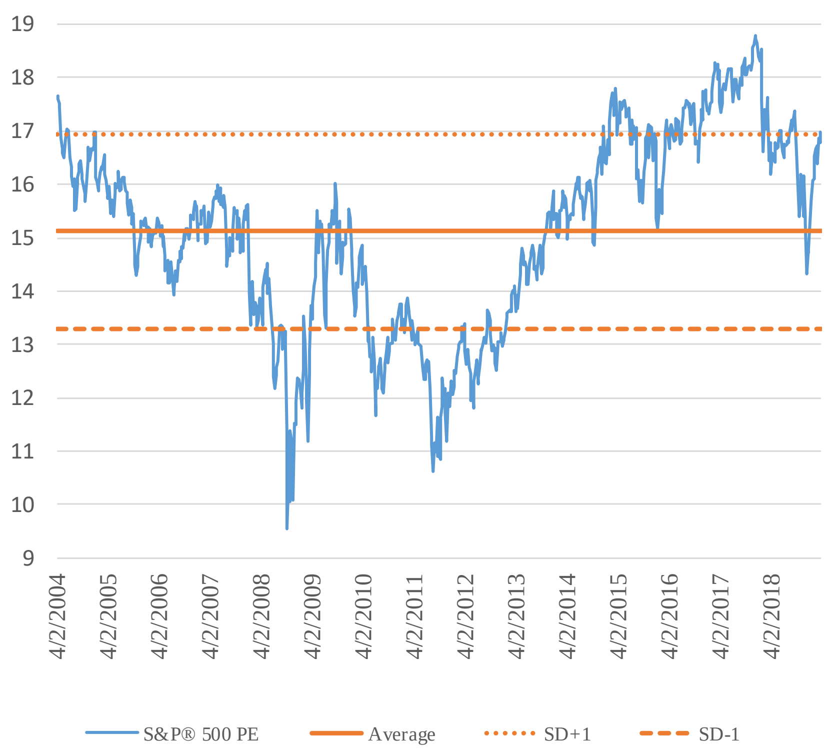
Weekly Report, Conference Call and Podcast

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.

PCM Market Model

4/6/2019 15:02	Forward P/E	Price to Book Value	Upside to Target
S&P® 500 Index	**16.8**	**3.4**	**7.4%**
Consumer Discretionary	20.9	8.1	8.1%
Consumer Staples	18.8	5.4	4.1%
Energy	17.0	1.8	11.7%
Financials	11.5	1.4	11.1%
Health Care	15.7	4.3	11.0%
Industrials	16.1	5.0	5.9%
Information Technology	19.3	7.2	3.0%
Materials	16.1	2.2	4.9%
Communications Services	16.4	3.5	10.9%
Utilities	18.5	2.2	1.1%
Real Estate	42.0	3.7	0.1%

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



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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.

About Mr. Harman:
Bryn Harman, CFA is the Chief Investment Officer and Chief Executive Officer of PCM. Mr. Harman holds a Bachelor of Commerce degree (Finance and Economics) from the University of Saskatchewan (1992) and he earned the Chartered Financial Analyst designation in 1997. Bryn began his career with a financial planning firm in 1994. Since then, Bryn has worked in several investment and corporate finance roles in Western Canada and the Pacific Northwest. Bryn is the former Director of Research for an investment management firm that had over $2 billion in assets under management at the time. Mr. Harman has been a portfolio manager with PCM since 2011 and he has held the position of Chief Investment Officer since 2013. Mr. Harman is a 50% owner of Palouse Capital Management.