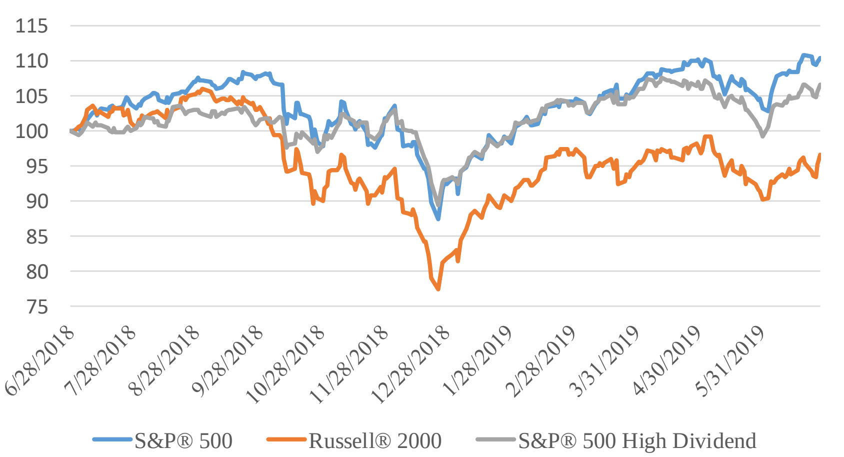
PALOUSE CAPITAL MANAGEMENT, INC.
Quarterly Commentary for 2Q19
July 2019

QUARTERLY RECAP

	Last Quarter	Previous Quarter	YTD	Past Twelve Months
S&P 500®	4.3%	13.6%	18.5%	10.5%
S&P 500® Equal Weighted	3.7%	14.9%	19.2%	8.3%
Russell 2000®	2.1%	14.6%	17.0%	-3.4%
S&P 500® High Dividend	1.6%	12.2%	14.1%	6.7%
Consumer Discretionary	5.3%	15.7%	21.8%	10.4%
Consumer Staples	3.7%	12.0%	16.2%	16.2%
Energy	-2.8%	16.4%	13.1%	-12.7%
Financials	8.0%	8.6%	17.2%	6.2%
Health Care	1.4%	6.6%	8.1%	13.2%
Industrials	3.6%	17.2%	21.4%	10.7%
Technology	6.1%	19.9%	27.1%	14.3%
Materials	6.3%	10.3%	17.3%	3.5%
Telecom	4.5%	14.0%	19.1%	12.9%
Utilities	3.5%	10.8%	14.7%	19.1%
Real Estate	2.5%	17.5%	20.4%	17.0%
Crude (WTI)	-2.8%	32.4%	28.8%	-20.4%
10 Year Treasury Rate	-16.6%	-10.4%	-25.3%	-29.3%
30 Year Treasury Rate	-10.1%	-6.6%	-16.1%	-14.7%
Dollar Index	-1.2%	1.2%	0.0%	0.9%
Vix	10.0%	-46.1%	-40.7%	-10.5%

Index Performance, Past 12 Months



Market Recap

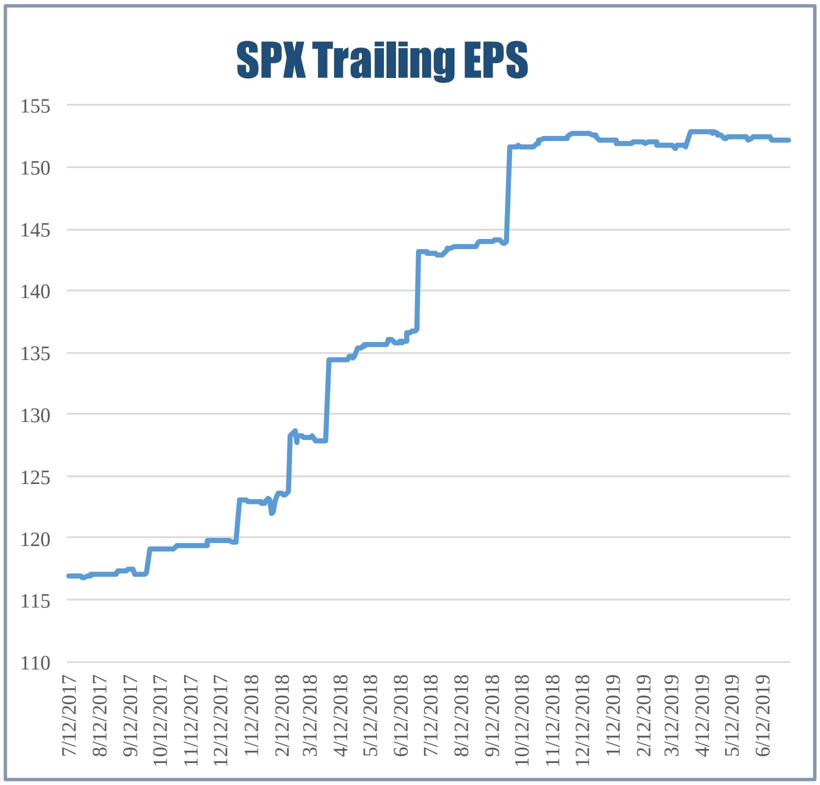
Domestic equity markets had a decent 2Q19, although they were not as strong as in 1Q19. The S&P 500® index ("SPX") was up a little over 4% in the quarter, led by strength in financials, technology, materials and consumer discretionary stocks. Small caps did not do as well as large caps in 2Q19, continuing a trend; the Russell 2000® index was up 2.1% in 2Q19, but it is currently down 5.8% in the past twelve months. Small caps corrected a lot more than large caps did in 4Q18.

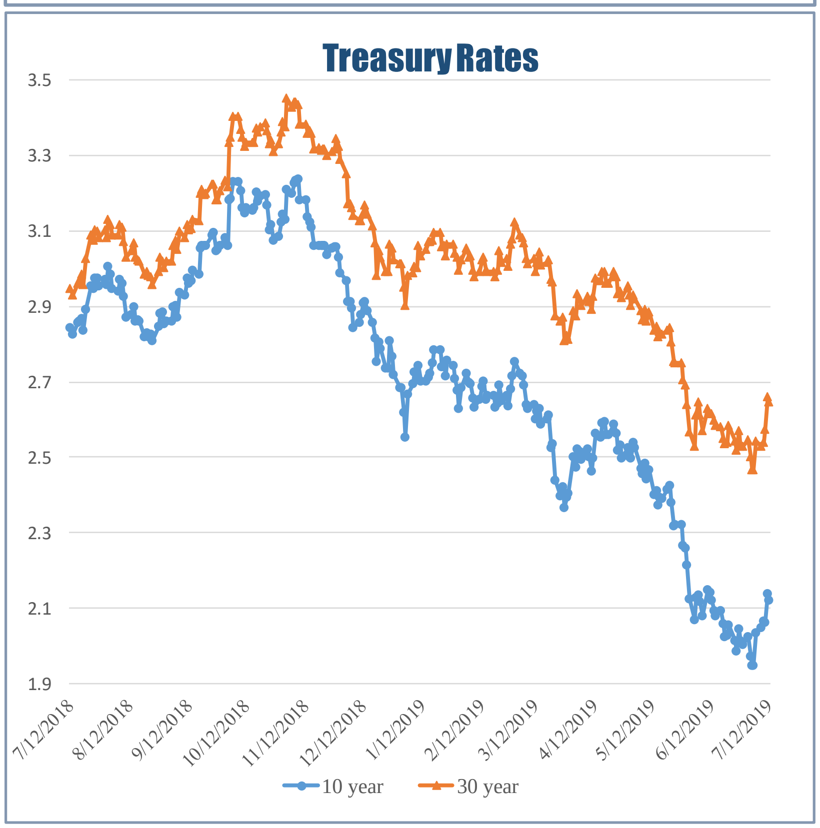
The quarter was marked by increased volatility, and the SPX was down almost 7% in May, mostly from worries about the trade war. June was a particularly strong month and the SPX hit an all-time record right at the end of the quarter. The SPX was up 18.5% in the first half of 2019, which was a great six month move. From the end of June 2018 to now, the big market is up a little over 10%, which is like a "normal" annual return for stocks.

Interest rates continued their downward slide in 2Q19. The ten year treasury rate fell below 2% for a time at the end of the quarter, down from over 3% last autumn. The treasury yield curve continued to invert in 2Q19, and the three month T-Bill rate was higher than the ten year treasury rate at the end of the quarter. The inverted yield curve is a scary phenomenon because it has been associated with economic recessions and bear markets in the past.

Bryn Harman, CFA ✧ Palouse Capital Management, Inc. ✧ 509-220-4253 ✧ bharman@palousecap.com
2026 N. Washington Street, Spokane, WA 99205

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





The SPX's trailing EPS is currently $152.20, almost exactly the same level as back in October of 2018. The trend in both trailing and forward EPS for the SPX is very flat going back nine months, which is a divergence from the positive trend that existed for several years before that. Market watchers have frequently referenced the expectation of an "earnings recession" in recent months. While the current trend is definitely not positive, I would not yet call it an earnings recession, although time will tell as we make our way through the current earnings season.

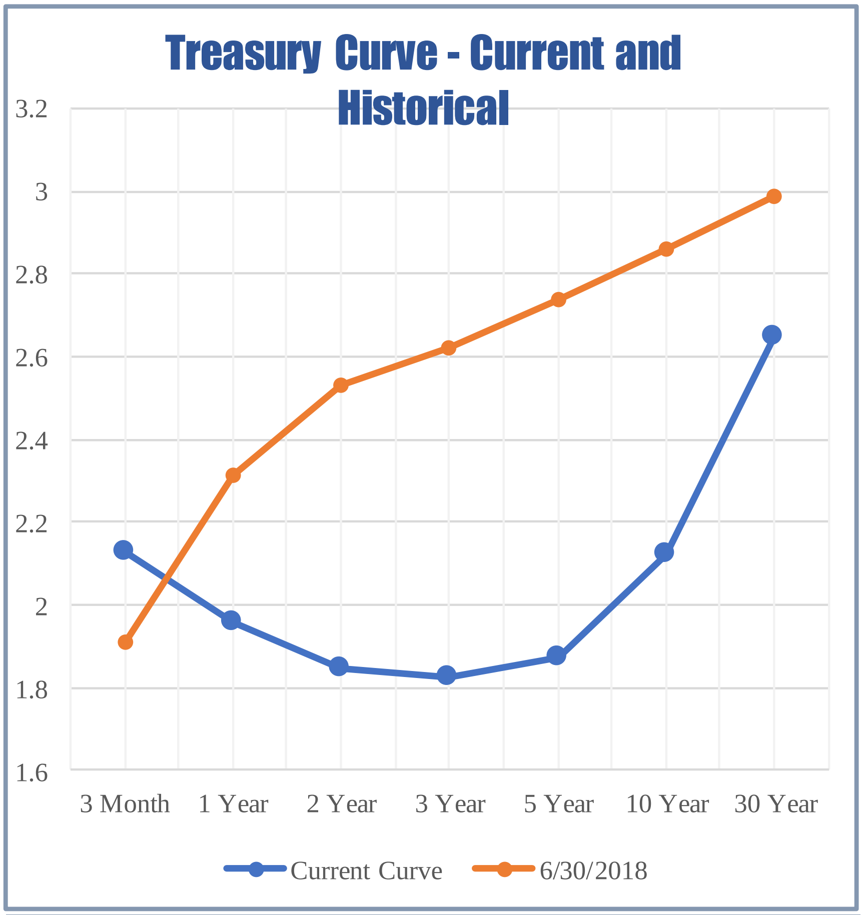
Market Model and Outlook

Our simple market model, which is based only on average sell side target prices, now suggests a 7% one year upside to the SPX, a number that is on the low side of the historic range[1]. There are now 234 of the 505 SPX names (46.3%) with one year upside potential less than 5% and 123 SPX names (24.4%) with one year upside potential less than zero. Consumer staples and utilities now have one year upside potential of less than 2%. The SPX's forward P/E multiple is now 17.3x, a little higher than last week and on the high side of the historic range.

I continue to think the market looks toppy here, although because we are just going into an earnings season, I am not as concerned as I would be if earnings season was over. That said, earnings will have to be decent to keep the market at this level. Given the flat looking earnings trend, I think the market has a significant risk of correction right now.

I tend to focus on the forward P/E ratio when I think about the overall valuation of the market.

[1] If you would like to learn more about our market model, please contact Bryn.



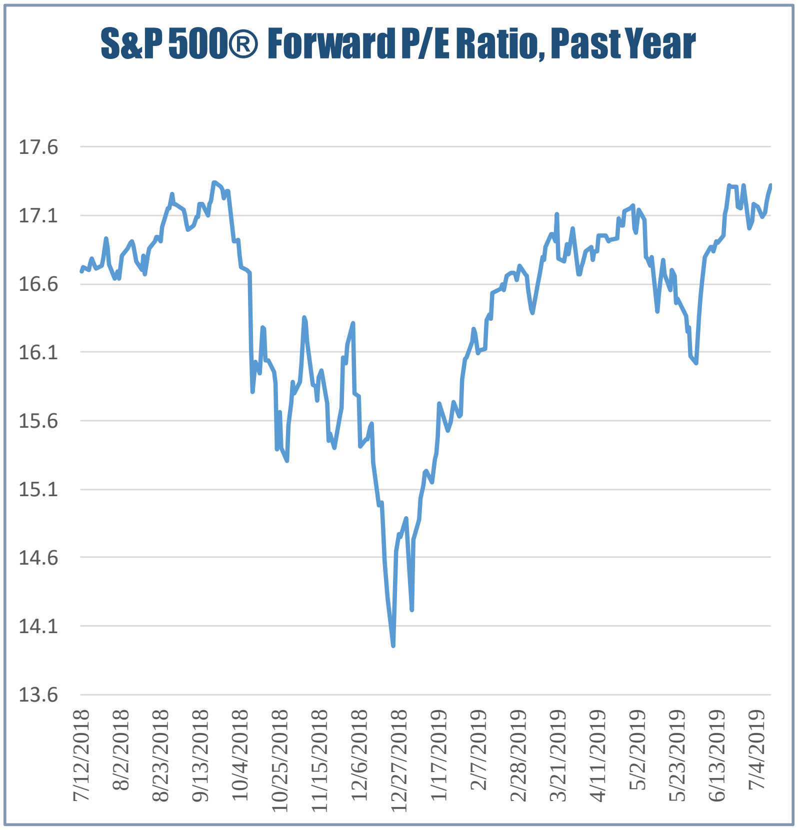
PCM Market Model

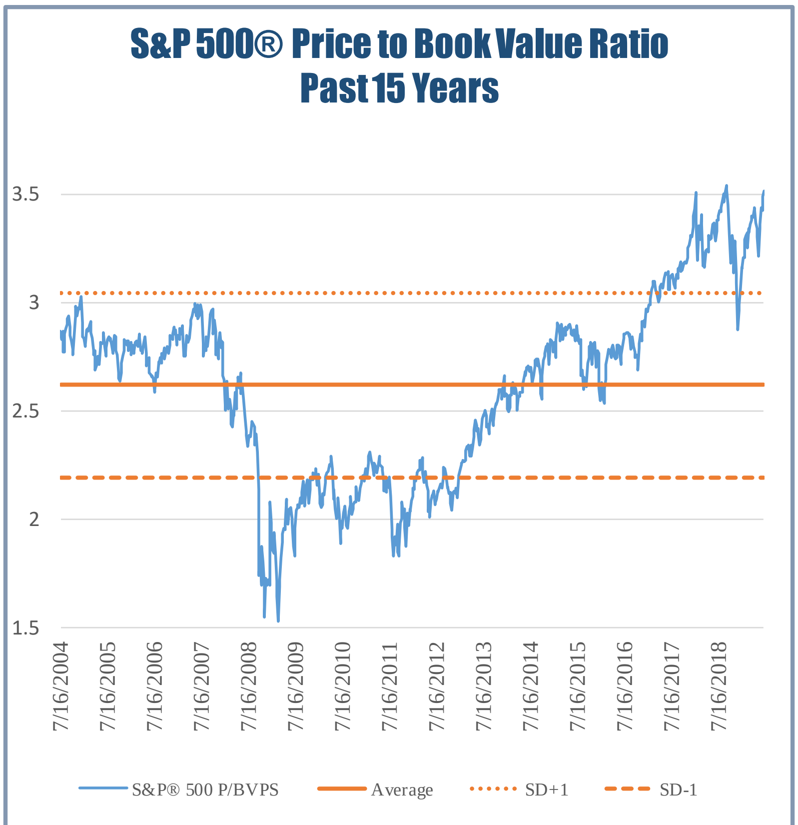
7/15/2019 17:29	Forward P/E	Price to Book Value	Upside to Target
S&P® 500 Index	**17.3**	**3.5**	**7.0%**
Consumer Discretionary	22.0	8.4	6.6%
Consumer Staples	19.9	5.9	1.8%
Energy	15.5	1.7	15.7%
Financials	12.2	1.5	7.0%
Health Care	15.5	4.3	10.9%
Industrials	16.2	5.0	7.3%
Information Technology	20.4	7.8	3.9%
Materials	17.3	2.5	5.2%
Communications Services	17.0	3.4	10.7%
Utilities	19.2	2.2	1.6%
Real Estate	42.1	3.8	2.1%

Right before the second 2018 correction the market's forward P/E multiple was exactly where it is now - and trailing earnings are essentially flat since then. Another factor I occasionally consider is the price to book value multiple (P/BV). I have always thought of the book value and tangible book value of stocks as proxies for floor value, although I have seen situations in which stocks have traded below these measures. In any event, I noticed this week that the current SPX P/BV is 3.51x, on the very high end of the historic range (the fifteen year average is 2.6x and the maximum was 3.53x in that time frame). The only times in the past fifteen years that the P/BV has reached 3.5x were the peaks reached right before the two 2018 corrections. While I am not suggesting that the P/BV trend is a good indicator of a potential correction, especially in a very low interest rate environment, the current level of the P/BV multiple does seem ominous.

Considering several economic factors such as the flattening earnings trend, a potentially slowing domestic and world economy and the inverted yield curve, it seems like a bear market could be in the works. While equity markets have a long term tendency to rise (and for good reasons) corrections and bear markets are a fact of life for equity investors. While the current bull run has been awesome – it is the longest bull market in history – a bear market is inevitable at some point in time.

While the last two bear markets were very painful (both resulted in a halving of equity market value), that does not mean that the next bear will be as bad. The 2000-2002 bear market was severe because equity valuations, pushed by the dot com bubble, were very high in the





late 1990s. The 2007-2009 bear market was severe because of the financial crisis and a profound recession. While valuations (i.e. the market's forward P/E multiple) are currently on the high side, they are nowhere near where they were in 2000. While I suppose some kind of economic tempest like the last financial crisis could be in the works, it seems unlikely that a crisis as bad as the last one would happen again, at least not right now.

There is no way to accurately call the top or bottom of an equity market cycle. Equity investors are wise to keep in mind that equity investing is a long-term endeavor and that equity markets tend to rise over long periods of time. Also, dividends are an important part of long-term returns. For most investors, it is important to diversify, notably by including at least two asset classes in one's portfolio – and this might be especially important during an equity market downturn. It is for those reasons, among others, that we created our Diversified Income strategy almost nine years ago. If you would like to learn more about our Diversified Income strategy, please call in to our office at 1-800-624-3833 and ask to speak to Barry, Ken, Spencer or Bryn.

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.

Important Disclosures:

Past performance is not a guarantee of future results and there is no assurance that any predicted results will actually occur; actual events and results may differ materially from those discussed herein. The opinions expressed are those of Palouse Capital Management, Inc. (PCM), and are based upon information available at the time of the printing of this report, and subject to change. Furthermore, these opinions are not the opinions of your custodian or broker. The information provided in this report should not be considered a recommendation to invest in a particular security, strategy or purchase or sell securities in a particular industry or sector. There is no assurance that securities or securities within the sectors mentioned in this report will be in a client's portfolio. Holdings are subject to change. This information is not intended to be used as the primary basis of investment decisions nor should it be construed as advice designed to meet the particular investment needs of any specific investor. Approved for investment professional and client use. Small-cap investing typically carries more risk than investing in well-established large cap companies since smaller companies generally have limited product lines and financial resources and a higher risk of failure. Historically, smaller companies' stocks have experienced a greater degree of market volatility than the average stock. PCM's Small/Mid Value Strategy may not be suitable for 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.

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.