

PALOUSE CAPITAL MANAGEMENT, INC.

Quarterly Commentary for 2Q20

July 2020

Top 1,000 - Market Cap Changes*

7/13/2020 4:36	Five Day	Three Months	YTD	One Year
Top 1,000	2.0%	19.2%	1.2%	8.9%
Largest 100 Equities	2.9%	20.3%	7.4%	17.2%
Largest 500 Equities	2.2%	19.3%	3.0%	11.1%
Smallest 500 Equities	-0.3%	18.8%	-14.7%	-10.1%
Consumer Discretionary	5.7%	40.2%	20.3%	23.3%
Consumer Staples	2.3%	5.4%	-4.5%	1.0%
Energy	-4.5%	4.5%	-40.1%	-42.4%
Financials	2.4%	8.9%	-23.0%	-16.2%
Health Care	0.3%	11.8%	4.7%	15.9%
Industrials	-0.8%	10.7%	-12.8%	-6.4%
Information Technology	3.2%	29.5%	20.0%	35.6%
Materials	0.7%	17.2%	-6.7%	-0.7%
Communications Services	5.0%	25.2%	8.0%	15.8%
Utilities	2.8%	2.6%	-7.0%	-0.9%
Real Estate	-2.2%	5.8%	-9.0%	-5.1%

*All calculations based on internal analysis of 1,000 domestic companies. Changes are based on the change in float adjusted market cap for companies that were in the model at the beginning and end of each period. The model does not use published index data and does not include the effect of dividends.

Market Recap

After a wild start to 2020, mostly attributable to the Covid-19 pandemic, equity markets surged in 2Q20; large cap stocks were up about 20% during the quarter. Small caps did even better, returning about 22% in the same time frame. While those numbers are very impressive, they seem small compared to the market's returns from March 23rd (the bottom of the correction) to now – large caps and small caps returned about 42% and 40%, respectively, in that time frame. The correction, which resulted in a large cap market loss of about 34%, lasted only 33 days (from February 19th through March 23rd).

The best sector in 2Q20 was consumer discretionary, which was up 33%. Consumer discretionary stocks fell about 32% during the correction, and they are now back to pre-correction levels. The worst sector in 2Q20 was utilities, which only gained 2.7%. Among the big winners in 2Q20 were large energy stocks, which were pounded during the correction. Some of the notable large cap losers in 2Q20 were Xerox Holdings Corp., Biogen Inc. and Cincinnati Financial Corp.

As is widely known, the covid-19 pandemic has had an unprecedented effect on the global economy and capital markets. 1Q20 domestic GDP dropped about 5% quarter over quarter, the biggest decline since 4Q08. Interest rates tumbled as the Fed dropped the lower bound of the Fed Funds Rate back to zero. The 10 year treasury rate is now 64 basis points, the lowest level in the available data set going back to 1962. Unemployment shot up to 13%, by far the

Other Data

7/13/2020 4:36	Last Data Point	One Week Change	Three Month Change	One Year Change
Crude Oil (WTI)	\$39.62	-2.5%	76.6%	-34.4%
Gold Spot	\$1,803.55	1.6%	6.3%	27.1%
Fed Funds Upper Bound	0.25%	0 bp	0 bp	-225 bp
Fed Funds Lower Bound	0.00%	0 bp	0 bp	-225 bp
Two Year Treasury Rate	0.15%	0 bp	-7 bp	-168 bp
Ten Year Treasury Rate	0.61%	-6 bp	-11 bp	-145 bp
Thirty Year Treasury Rate	1.31%	-11 bp	-3 bp	-126 bp
Two to Ten Spread	0.46%	-5 bp	-3 bp	23 bp
Dollar Index	\$96.70	-0.6%	-2.8%	-0.4%
Jobless Claims - New	1,314	-7.0%	-74.9%	522.7%
Jobless Claims - Continuing	18,062	-3.7%	14.2%	966.2%
Vix	29.26	5.7%	-55.4%	124.6%

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.

PCM All Cap Market Model

7/13/2020 4:36	Price to Earnings Ratio*	Price to Book Value**	Upside to Target	# Stocks
Top 1,000	23.9x	3.2x	4.5%	1,000
100 Largest Equities	24.2x	4.5x	2.4%	100
500 Largest Equities	23.5x	3.5x	3.5%	500
500 Smallest Equities	28.9x	1.8x	11.6%	500
Consumer Discretionary	52.4x	8.0x	-3.6%	116
Consumer Staples	18.2x	4.2x	6.8%	52
Energy	N/A	0.9x	22.6%	32
Financials	13.1x	1.0x	12.4%	131
Health Care	20.0x	4.7x	10.5%	153
Industrials	31.3x	3.9x	8.7%	131
Information Technology	27.0x	8.3x	-0.8%	181
Materials	22.5x	2.2x	4.6%	45
Communications Services	19.6x	2.8x	2.1%	41
Utilities	17.0x	1.8x	11.0%	44
Real Estate	48.7x	2.6x	7.9%	74

All calculations based on internal analysis of 1,000 domestic companies. The model does not use published index data.

* Calculated by comparing market capitalization to estimated earnings.

** Calculated by comparing market capitalization to last reported shareholder's equity.

highest rate in the available data set going back to 1962. The core inflation rate, as measured by the US Personal Consumption Expenditure index, fell from 1.8% in February to 1% in May.

With a clearly recessionary backdrop one might wonder why the stock market came roaring back in the past few months; a likely and obvious reason for this is that the stock market tends to lead the economy over time – and investors anticipated that the recession would be a short one. Another reason is that the correction was essentially an overreaction to the pandemic and stock valuations were extremely attractive at the end of March (I used the term “unprecedented buying opportunity” in my weekly report to clients on March 23rd). A third reason is the government’s aggressive actions to help individuals and businesses through the crisis. The week of March 23rd was one of the best weeks in stock market history, and it is no coincidence that it corresponded to the announcement of the government’s stimulus package.

Market Model and Outlook

Our simple market model - which is based only on average sell side target prices - now suggests that there is a 4.5% one year upside potential to the all cap market, a very low number in the historical context. To provide a frame of reference, the upside number was 51% on March 23rd, the highest number my models have ever generated. I am calculating the forward P/E multiple for the all cap market at 24x, a very high number.

While earnings expectations are way down from the beginning of the year, and for good reason, earnings visibility is currently very weak. A large number of management teams pulled their guidance after the crisis began. It therefore makes sense that there will probably be a lot of earnings surprises this earnings season because sell side analysts are often quite dependent on guidance when updating their financial models. That could lead to an above average level of volatility, but also some positive earnings surprises.

Equity markets seem generally fully valued right now, although with limited visibility there is risk to that statement. Earnings could be better than the sell side is now anticipating, and I have noticed a general and moderate improvement in

earnings expectations over the past few weeks. Super low interest rates also support relatively high trading multiples, at least in theory – and interest rates are at unprecedented lows right now.

Value investing and stock picking still work in market phases like the current one. Our screens are still producing buy ideas, although not as many as would be the case in lower multiple environments. Some sectors seem much pricier than others. This ought to be an interesting earnings season, as they usually are, and we expect to find some good buying opportunities in the upcoming weeks.

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:

Palouse Capital Management, Inc. ("PCM") is an SEC registered investment adviser located in Spokane, WA. Registered investment adviser does not imply a certain level of skill or training. PCM may only transact business in those states in which it is registered or has completed the appropriate notice-filing requirements. Prospective clients should consult with a financial consultant to review their investment objectives and financial situation before determining whether any investment, security, or strategy is suitable. A copy of PCM's Form ADV Part 2A & 2B providing information regarding PCM's services, fees, and other important disclosure items is available on PCM's website – please contact Bryn Harman at 509-220-4253 to obtain copies of these documents. Any opinions expressed in any PCM-authored documents are subject to change without notice and, due to the rapidly changing nature of the security markets, may quickly become outdated. No information should be interpreted to state or imply that past results are an indication of future performance. All materials presented are compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. No portion of this document should be interpreted as legal, accounting or tax advice.

All analysis in this report was provided by Bryn Harman, CFA, PCM's Chief Executive Officer and Chief Investment Officer. Mr. Harman can be reached directly at 509- 220-4253 or bharman@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 L.P. unless otherwise indicated.

The PCM market model examines the universe of the 1,000 largest actively traded equities trading in the United States (referred to as the "Top 1,000"). The "Price to Earnings Ratio" is calculated by comparing the total capitalization for each market cap range and each sector to the total estimated net income (from sell side estimates) for the respective market capitalization range or sector. The "Price to Book Value Ratio" is calculated by comparing the total capitalization for each market cap range and each sector to the total last reported shareholder's equity for the respective market capitalization range or sector. "Upside to Target" is calculated using float adjusted market capitalization weightings and the one year upside potential to the average sell side target price for each security.

"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.

“DI” means our Diversified Income Strategy.

“SPX” refers to 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 S&P SmallCap 600® index is a capitalization weighted index that measures the performance of 600 small capitalization stocks.

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.