Eagle Insight

EAGLE Asset Management
AN AFFILIATE OF CARILLON TOWER ADVISERS

All Cap Equity

Fourth Quarter | 2017

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Market Overview

The broad U.S. equity market (as measured by the Russell 3000 Index[1]) capped off a monumental year gaining 6.3 percent in the fourth quarter. That brought the total gain to 21.1 percent for 2017: the only year on record in which the market posted a gain in all 12 months. The macroeconomic backdrop was mostly favorable for equities, with a generally improving economic environment; rising business and consumer confidence; and very low market volatility. Crude oil continued creeping higher (up 19.5 percent) with help from declining inventory and uncertainty about additional supply. The U.S. dollar continued to weaken while inflation remains below historical levels.

Portfolio Review[2,3]

Eagle All Cap Equity portfolios underperformed the benchmark Russell 3000 Index during the fourth quarter. The growth-over-value trade continued to expand with the Russell 3000 Growth Index (up 7.6 percent) outperforming the Russell 3000 Value Index (up 5.1 percent).

We had poor stock selection in the healthcare, consumer discretionary and financials sectors. On the other hand, stock selection within the information technology and industrials sectors – as well as our zero weight in utilities – added to relative performance.

Microsoft announced strong earnings as every business unit reported higher-than-expected results. The cloud business, Azure, again grew almost 100 percent. The accelerating-growth thesis continues to play out for Microsoft.

Union Pacific appreciated because it's projected to be a beneficiary of tax reform. Domestic rail companies typically pay the full U.S. tax rate and would benefit from a lower rate.

Delta Air Lines moved guidance to the higher end of its existing range due to improving pricing. Delta continues to produce very strong free-cash-flow.

Total System Services reported another quarter of stronger-than-expected earnings. The company's pre-paid-card business was exceptionally strong due to expanded relationships with some key customers. The stock continues to trade at a discount to peers.

Home Depot reported better-than-expected earnings per share on higher same-store sales growth. The company benefited from a number of natural disasters in the quarter; further, the company raised guidance for the year.

Celgene faltered after it revised down its 2018 earnings guidance and announced the failure of the phase-3 trial for a potential Crohn's-disease drug. We believe the stock's sell-off overly discounts the actual impact to the company's intrinsic value.

Allergan suffered due to the loss of patent protection for its dry-eye drug coupled with what we believe is a short-term, reduced confidence in the management team. Allergan also traded lower because it won't benefit as much as others from tax reform.

Oceaneering International reported lower-than-expected revenue and suspended its dividend due to a diminishing cash-flow outlook. The offshore oil sector remains challenged; however, its overall business is getting better, albeit slowly.

General Electric traded lower after the new chief executive announced the company would be cutting its dividend in half. Some investors were

Value investing is based on the potential for a company's stock price to rise based upon anticipated changes in the market or within the company itself. Value stocks have historically been sensitive to economic cycles and investor sentiment that can affect volatility and risk.

disappointed in the reset but the change was necessary to realign with earnings. The company has spent the last several years divesting different business units while not appropriately adjusting the dividend.

Delphi Technologies was a spun-out segment of an existing holding, Aptiv. The company decided to spin out its more secularly challenged powertrain business, which subsequently traded lower. We sold stock quickly after the deal was finalized. We remain confident in our Aptiv position, which has more secular tailwinds.

Outlook[2]

Looking forward to 2018, we believe the outlook for the U.S. economy is similar to the view we had one year ago. That is, we expect continued moderate economic growth, growing corporate profits and further normalization of monetary policy. As the current economic expansion approaches its ninth anniversary, some investors have expressed concern that a recession is likely sometime soon since the current expansion already has lasted more than twice as long as historical averages. We do not share this concern. There is a natural tendency toward growth in the U.S. economy. Expansions do not die of old age but, rather, because of policy actions or major exogenous events. We believe that current policies are supportive of continued growth. In particular, on the fiscal and regulatory fronts, policies are becoming even more conducive to growth. A major tax-reform bill recently passed Congress with a key feature being a major reduction in the corporate tax rate. By some estimates, that could add about 10 percent to S&P 500 earnings next year. In addition, favorable terms for repatriation of the $2 trillion-$3 trillion in U.S. companies' cash stranded overseas is likely. That, in turn, could unleash a number of favorable actions for the U.S. economy and for shareholders. On the regulatory front, great progress in rolling back many growth-inhibiting policies of the previous administration already has been made. But further regulatory relief, particularly in the area of financial institutions, is in prospect.

Another way to think about the current environment is that we are just a couple of years into a "normal" economic environment. By this, we mean that the once-in-a-generation financial crisis that occurred nearly a decade ago left consumers and businesses in an extended period of fear and caution that, historically, only time can heal. The period from 2008 until just recently was depression-like in many ways: very slow growth, stagnant incomes, deflationary tendencies and a reluctance of businesses and consumers to spend and invest. Monetary policy came to the rescue with the most aggressive interest-rate and quantitative-easing programs ever seen. Monetary policy kept the real economy growing, if only slowly, but the major impact of monetary policy was on financial markets where a global bull market in equities and bonds ensued.

Time has passed. Balance sheets have improved. Consumer incomes are growing again. Business and consumer confidence are near record highs. And the United States is fortunate to have a business-friendly government eager to promote economic growth. The next recession and bear market are well over the investment horizon, in our view.

The recent appointment of Federal Reserve Governor Jerome Powell as chair of the board indicates to us that President Donald Trump wants a continuation of the gradual normalization of policy rather than radical change. As with this year, we believe three Fed interest-rate increases are likely in 2018. As equity investors,

Top 10 Holdings

Darling Ingredients
Microsoft
Union Pacific
Procter & Gamble
Apple
Citigroup
AMETEK
Intercontinental Exchange
AT&T
Delta Air Lines

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	Best Securities	Average Weight (%)	Security Contribution to Portfolio Return	Worst Securities	Average Weight (%)	Security Contribution to Portfolio Return
All Cap Equity	Microsoft	5.02	0.75	Celgene	1.38	-0.51
	Union Pacific	3.90	0.63	Allergan	2.06	-0.50
	Delta Air Lines	3.22	0.51	Oceaneering International	1.03	-0.38
	Total System Services	2.57	0.51	General Electric	0.89	-0.27
	Home Depot	2.93	0.47	Delphi Technologies	0.05	-0.07

* as of Dec. 31. The information provided above should not be construed as a recommendation to buy, sell or hold any particular security. The data are shown for informational purposes only and are not indicative of future portfolio characteristics or returns. Portfolio holdings are not stagnant and may change over time without prior notice. Past performance does not guarantee future results. Please note that the holdings identified do not represent all of the securities purchased, sold or recommended for the composite. They are provided for informational purposes only. Eagle, its affiliates or their respective employees may have a position in the securities listed. Please contact your financial advisor to obtain the calculation's methodology and/or a list showing every holding's contribution to the overall composite's performance during the measurement period.

we do not fear modest increases in interest rates. Historically, rising rates from a low level – in a low-inflation environment – has not been a negative factor for stocks. Price-to-earnings ratios are a bit above average but, compared to current interest and inflation rates, they are well within historical norms.

Just as was the case in 2017, we believe the broad stock market averages can rise in line with earnings in 2018. However, we believe that a change in the nature of the market is likely. During a period of economic uncertainty, investors tend to flock to a relatively small number of companies with strong revenue growth and good earnings visibility. Valuation takes on a secondary role if it is even considered at all. That is the milieu of growth and momentum investing, which has been dominant recently and especially in 2017. Looking forward, we believe – for a number of reasons – there will be a revival of value investing and that our strategy and portfolio are well-positioned to participate.

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[2] References to specific securities are intended to illustrate the types of securities Eagle may hold in this portfolio. They are not intended as representations of specific investment recommendations that would have been profitable to an investor. Past performance is not a guarantee of future results. Opinions and estimates offered constitute Eagle's judgment and are subject to change without notice as are statements of financial-market trends, which are based on current market conditions. Investing involves risk, including the possible loss of principle.

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[3] Source: FactSet