Eagle Insight

EAGLE | Asset Management
AN AFFILIATE OF CARILLON TOWER ADVISERS

Large Cap Growth

Fourth Quarter | 2017

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The risks associated with Large Cap Growth investing are that growth-oriented companies are expected to increase their earnings at a certain rate. When these expectations are not met, investors may punish the stocks excessively, even if earnings showed an absolute increase. Growth company stocks also typically lack the dividend yield that can cushion stock prices in market downturns. The companies engaged in the technology industry are subject to fierce competition and their products and services may be subject to rapid obsolescence. The values of these companies tend to fluctuate sharply.

Market Overview

2017 demonstrated why forecasting is difficult, and market timing is dangerous. The year showed that elevated valuations and low volatility (cyber-currencies aside) can be sustained for longer than many expect, especially when growth delivers.

The U.S. economy picked up steam in 2017 with back-to-back quarters of greater than 3 percent growth and the Atlanta Federal Reserve Bank expects an estimated 4.5 percent growth in the fourth quarter. Additionally, the employment picture remains healthy: jobless claims were near record lows, unemployment was at 4.1 percent and there were a robust 228,000 jobs added in November, according to the U.S. Bureau of Labor Statistics. Housing is also picking up again, with housing starts rising nearly 14 percent in November, and existing housing inventory is down 10 percent on a year-over-year basis. Sustained, above-trend economic growth has helped companies deliver on earnings, fueling strong equity returns. 2017 earnings will be a tough act to follow; however, the boost from the recently passed tax cuts should add meaningfully to 2018 earnings.

2017 also demonstrated the capacity for equity markets to climb a "wall of worry." Investors began the year uncertain about the new President Donald Trump administration, the potential for trade protectionism and escalating geopolitical tensions. In addition, there was an anti-Euro election scare in France, nervousness about the Fed's balance-sheet reduction plans and worries about North Korean aggression. The events many worried about in early 2017 didn't materialize and markets responded very positively.

Portfolio Review[1,2,3]

Eagle Large Cap Growth portfolios slightly underperformed the benchmark Russell® 1000 Growth Index. Sector allocation and stock selection were both slightly negative. An overweight position in information technology (IT) and an underweight position in real estate contributed to performance. Stock selection was weakest within IT and healthcare, but strong within consumer discretionary and industrials.

Amazon.com reported strong results from its Prime Day (its equivalent to traditional retailers' Black Friday) and the fastest growth rate yet of its Amazon Web Services, which were helped by its international expansion and the introduction of a monthly payment option.

Microsoft reported strength in its cloud business driven by increased usage and engagement. Revenue from its cloud platform nearly doubled; meanwhile, the company suggested it is pursuing further opportunities in the cloud as well as artificial intelligence.

Apple benefitted from robust demand for its costliest iPhone model, with delivery times lengthening to six weeks at the end of October. Services revenue from Apple Music and Apple Pay was strong. The company also gained market share in China and emerging markets.

Alphabet, the parent company of Google, reported strong quarterly earnings driven by strength in Mobile Search and YouTube. The company also saw increased revenue from hardware and cloud products.

D.R. Horton, a homebuilding company, released strong earnings results, despite the effects of Hurricanes Harvey and Irma. This highlights the favorable housing market environment and the company's leading market share.

Celgene, one of the world's biggest biotech companies, announced it would be discontinuing development of a Crohn's disease drug due to late-stage trial failure.

Pharmaceutical company Gilead Sciences was hurt by concerns regarding competition in the hepatitis drug market and downward pricing pressure.

Videogame-maker Electronic Arts reported underwhelming sales of its new Star Wars game. Users had a negative reaction to the game's heavy reliance on microtransactions, resulting in a temporary suspension of in-game purchases.

Biotechnology company Amgen released weaker-than-expected revenue, primarily due to slipping sales of its top two drugs. Competition from biosimilars was also a headwind.

Medical device-maker Cooper Companies was hurt by unfavorable exchange rates, costs related to integration and facility start-ups and a competitive contact lens environment.

Outlook[2]

The synchronized global expansion has room to run as strong corporate earnings and steady global growth support equity markets. However, geopolitical risks, inflation and other factors could make 2018 challenging. That said, we are also skeptical of the typical Wall Street exercise of publishing year-end stock market outlooks because what we don't know today frequently overwhelms what we do know.

There doesn't appear to be any change in the plans of the Federal Reserve to continue normalizing policy. However, with Jerome Powell taking over the Fed chair position from Janet Yellen and other new members set to be appointed, uncertainty is elevated. Judging by the comments from Powell during his confirmation hearings, continuity and transparency are priorities; however, if inflation flares up, or growth lags, the Fed may be challenged. Similarly, global central banks are likely to gradually curtail easy monetary policies and are not likely to move aggressively and scare markets.

Investors should be careful – in our view – not to extrapolate 2017's performance into 2018. The global bull market is intact, supported by solid global growth and strong corporate earnings; however, we anticipate more frequent bouts of volatility. Pullbacks are increasingly possible given that expectations are now set quite high. If inflation stays low, high valuations can continue to be supported. Low inflation and low rates have been key pillars of equity-market support, reducing the cost of capital and enhancing earnings yields. However, if this assumption proves wrong, multiple compression and a spike in volatility are likely. As always, investment discipline is critical when looking ahead into an unknowable future.

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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.

Top 10 Holdings

Apple
Microsoft
Facebook
Amazon.com
UnitedHealth
Alphabet (Class A & C)
Home Depot
McDonald's
Applied Materials
Lear

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	Best Securities	Average Weight (%)	Security Contribution to Portfolio Return	Worst Securities	Average Weight (%)	Security Contribution to Portfolio Return
Large Cap Growth	Amazon.com	4.00	0.80	Celgene	0.97	-0.38
	Microsoft	5.18	0.77	Gilead Sciences	0.69	-0.18
	Apple	5.48	0.56	Electronic Arts	1.22	-0.15
	Alphabet	4.98	0.44	Amgen	1.94	-0.14
	D.R. Horton	1.47	0.37	Cooper Companies	1.14	-0.09

* 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.

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[3] Source: FactSet