Eagle Insight

EAGLE | Asset Management
AN AFFILIATE OF CARILLON TOWER ADVISERS

Mid Cap Growth

Third Quarter | 2018

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Market Overview

Mid-cap stocks continued their upward trajectory during the third quarter of 2018 as the Russell Midcap® Growth Index[1] (up 7.6 percent) outperformed the Russell Midcap® Value Index (up 3.3 percent). Sector-level returns in the Russell Midcap® Growth Index were led by strong results within health care (up 12.3 percent), information technology (up 12.2 percent) and the industrials (up 9.4 percent) sector. Relative laggards were communication services (down 9.4 percent), materials (down 5.0 percent) and real estate (down 1.8 percent) which somewhat tempered the Growth benchmark's otherwise solid performance during the quarter.

Portfolio Review[2,3]

Eagle Mid Cap Growth portfolios outperformed the benchmark Russell Midcap® Growth Index on a gross and net basis. Outperformance was primarily driven by the portfolios' strong absolute and relative results in the information technology sector. Positive relative results within the health care sector also boosted performance. Our holdings within the communication services and industrials sectors trailed the benchmark, somewhat tempering the portfolios' broader outperformance.

Advanced Micro Devices saw increased adoption in datacenter markets through the application of its graphics-processing units used in artificial intelligence, machine learning and other heavy-duty computing.

Square, a mobile-payment service, is experiencing rapid growth due to its easy-to-use hardware and strong capabilities in software.

Shares of Illumina, which manufactures genetic sequencing equipment and systems, posted strong quarterly results in addition to raising guidance. Demand for its high-end sequencers has continued to remain robust.

Splunk, which is a provider of software that analyzes data coming from network appliances, has experienced healthy growth in revenue. Strong demand is coming from the security segment, where the firm has the ability to analyze network security equipment to help detect cybersecurity attacks.

Centene operates Medicaid managed-care programs for several U.S. states. Shares rose as the firm benefitted from ongoing expansion into new markets. We believe a recent strategic acquisition should help provide added growth prospects in the approaching periods.

IPG Photonics makes lasers used for cutting and welding. Shares declined as the firm reported disappointing results and guidance, attributable primarily to tariff and trade war-related concerns hurting end demand. We still believe in the secular growth story of fiber lasers replacing CO2 lasers, and the company's vertical integration strategy to fend off competition.

Construction materials supplier Martin Marietta Materials encountered some near-term weakness in cement pricing, while also seeing more weather-related delays during the period.

Videogame maker Electronics Arts saw shares decline as the expected launch of its high-profile title Battlefield V was delayed. The firm subsequently trimmed guidance as a result. While disappointing in the near-term, we possess a favorable view of EA's gaming line-up and its ability to navigate an ever-evolving industry as e-Sports and competitive gaming in general continue to grow rapidly in relevance.

Microchip Technology is a microcontroller semiconductor company. The firm encountered

acquisition-related growing pains during the period, which have proven challenging in the context of a potential slowdown in the semiconductor industry. In our opinion the firm possesses a solid track record of effectively integrating and leveraging strategic acquisitions; however, we are keeping a close eye on signs of deterioration within the semiconductor end markets.

bluebird bio is a biotechnology firm engaged in developing immunotherapy-focused treatments for a variety of cancer indications. While we possess a favorable longer-term view on the name given Bluebird's robust platform with several compelling drug candidates in its development pipeline, potential competition from industry peer Amgen weighed on shares of Bluebird during the quarter.

Outlook

As we enter the fourth quarter, equity markets appear to be focused on several issues which could potentially portend the end to the extended bull market, despite extremely strong economic data. First and foremost, eyes are on the Federal Reserve (Fed). Is the Fed raising rates too high? Or too fast? While the Fed's actions may be appropriate longer term, interest rates are beginning to follow the rise in shorter duration rates. Already the important housing sector is slumping. The escalating trade war with China also threatens to dampen economic growth with certain sectors being disproportionately affected. We are of the opinion that it is in everyone's interest to resolve the trade dispute and ultimately it will be resolved; the question is, how long will it take? The November 2018 midterm elections are also a factor: if Republicans lose their majority in the House of Representatives, it could be seen as a setback to the Trump administration's pro-growth agenda. On a positive note, the underlying reason the Fed is raising rates is because the economy is so strong. Economic growth should approach four percent, unemployment is at record lows, wages are finally moving higher and consumer confidence remains high. It all presents an interesting puzzle for the remainder of the year.

The outlook for the energy sector appears balanced as oil prices have risen to levels that support a balanced market. Specifically, we believe that oil above $70/barrel will encourage drilling activity to grow production enough to meet demand. Risk to the upside in oil prices appears most likely to arise from a supply shock due to a decrease in production from unstable producing nations such as Venezuela. Conversely, we also see possible risks to the downside for oil prices from an economic slowdown in emerging economies, such as China. In the context of this balanced view, we remain optimistic on the outlook for oil production in the Permian Basin in West Texas and continue to believe that exploration and production (E&P) operators with attractive leasehold positions represent compelling investments.

The outlook for the industrials and materials sectors has – broadly speaking – diminished as investors grapple with the sustainability of the current economic expansion. Taking a cue from the uptick in interest rates, investors have grown increasingly concerned that 2019 could represent the peak in the economic cycle and are re-rating valuations accordingly. This dynamic is especially notable in early-cycle industries such as housing and automobiles, as share prices have declined despite higher earnings. Against this backdrop, we continue to favor companies that are exposed to secular growth drivers which can help offset headwinds in a more sluggish economic environment.

Top 10 Holdings

Waste Connections
Burlington Stores
ABIOMED
Align Technology
TransUnion
Advanced Micro Devices
Sirius XM Holdings
SBA Communications Class A
IDEXX Laboratories
Centene Corporation

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Mid Cap Growth

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	Top Securities	Average Weight (%)	Security Contribution to Portfolio Return	Bottom Securities	Average Weight (%)	Security Contribution to Portfolio Return
Mid Cap Growth	Advanced Micro Devices	2.14	1.68	IPG Photonics	1.04	-0.39
	Square	1.22	0.62	Martin Marietta Materials	1.63	-0.32
	Illumina	1.41	0.36	Electronic Arts	1.27	-0.18
	Splunk	1.48	0.30	Microchip Technology	1.30	-0.17
	Centene	1.62	0.27	bluebird bio	0.54	-0.14

*As of Sept. 28. 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.

Investments in mid-cap companies generally involve greater risks than investing in larger capitalization companies. These companies often have narrower commercial markets and more limited managerial and financial resources than larger, more established companies. As a result, their performance can be more volatile and they face greater risk of business failure, which could increase the volatility of a fund's portfolio. Additionally, small-cap companies may have less market liquidity than larger companies.

Growth 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.

In our opinion, the current environment remains poised to support greater-than-GDP growth rates within the healthcare industry given the combined tailwinds of an aging population, longer lifespans, the crippling impact of chronic conditions and new medical innovations. The adoption of high-deductible health plans, coupled with health savings accounts (HSAs), has forced employees to shoulder a much larger burden of their insurance premiums and other out-of-pocket healthcare expenses, ultimately encouraging patients to scrutinize their care-related decisions. We also believe that consolidation through mergers & acquisitions (M&A) activity is likely to continue throughout the health care industry.

We strive to identify healthcare companies providing "cash-pay" products and services (e.g., aesthetics, veterinary products and services as well as dental and orthodontic procedures). The products and services that these types of companies provide are targeted directly at the consumer and subsequently tend to have little regulatory or reimbursement risk from the federal government. The ongoing innovation of telemedicine continues to drive rapid adoption by managed care and health care systems, particularly due to the convenience of improved access to quality care while at a lower cost compared to conventional primary care office visits. We continue to pursue opportunities in biotech firms developing revolutionary and innovative therapies to treat diseases and conditions which would have otherwise been chronic, expensive, or fatal.

The outlook for the financials sector remains constructive in our view – albeit with some persistent headwinds. Couple the flattening of the yield curve with an environment where loan demand has remained lackluster, and we see the Fed moving rates higher and the bank stocks underperforming. We expect this tug-of-war between the Fed and the market to continue and we prefer banks with asset-sensitive balance sheets that will benefit from Fed moves over time. Beyond the macroeconomic-level drivers within financials, we see opportunities in firms exposed to areas of the country experiencing outsized job and employment growth. The environment for deal-making remains relatively favorable where opportunities exist for boutique investment banks to grow and take share from the much larger bulge bracket firms. We are also seeing opportunities in the consumer payments space as payment methods evolve in response to millennials' banking behavior. Finally, we believe select domestic U.S. consumer pawn operators possess the potential

to leverage their business models abroad, with expansion into Latin America providing growth prospects to complement their more mature core domestic operations.

Consumer stocks had a strong third quarter, led by good performance from specialty retailers. Looking to the fourth quarter, strong performance is expected to continue as consumer confidence remains near historic highs, unemployment is low and, belatedly, wages are starting to creep higher. Importantly, the set-up for the holiday season appears favorable as early expectations are for a strong holiday season. In our view, most retailers have developed a stronger balance between brick-and-mortar and online capabilities. While the consumer looks healthy, certain consumer stocks may be in the crosshairs of higher tariffs. With the Federal Reserve continuing to raise interest rates, housing as well as housing-related stocks figure to perform poorly.

In the current environment, the domestic economy appears poised to continue growing at a robust pace and although emerging markets have seen some pressure, the overall global macroeconomic trends have remained strong. As such, we remain optimistic regarding technology-related spending into 2019. With lower tax rates flowing through corporate America, technology spending should remain robust both at the enterprise and consumer levels. Furthermore, unemployment rates continue to tick down while both consumer confidence and small business optimism remain healthy. Despite recent interest rate increases, we would expect merger and acquisition (M&A) activity to continue given very strong balance sheets at the very large technology companies, in addition to a sympathetic political environment in Washington. We remain focused on high quality companies with strong management teams that are well-positioned to gain market share. Additionally, we continue to pursue investment opportunities that benefit from long-term secular growth trends with themes that include cloud computing, artificial intelligence, mobility, e-commerce/digital payments, smart home, factory/industrial automation, security software, e-gaming, and alternative energy.

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3. Source: FactSet, Frank Russell Co. Statistics represent an aggregate of all Mid Cap Growth portfolios.