EAGLE GLOBAL ADVISORS

Quarterly Commentary
4Q 2022

EGA U.S. Equity

From the EGA Portfolio Management Team

Markets rallied in the fourth quarter, but the year still ended as one of the worst annual declines in the last 90 years. The S&P 500 returned 7.6% in the quarter, cutting the negative return for the year to -18.1%. Decent earnings in the third quarter calmed fears that an economic slowdown was imminent, and the fixed income market stabilized after digesting the precipitous increase in short-term rates initiated by the Federal Reserve in March. The dollar fell and while short-term interest rates rose, long-term interest rates were stable and corporate risk spreads were slightly down generating positive returns for fixed income holdings for the first time in 2022.

Economic growth has slowed quickly this year after the incredibly strong snap back in 2021. Furthermore, higher prices are crimping consumer and producer appetites. The fact that the Federal Reserve is applying the monetary brakes at a time when the economy is naturally slowing raises the risks to the outlook for the economy and equities.

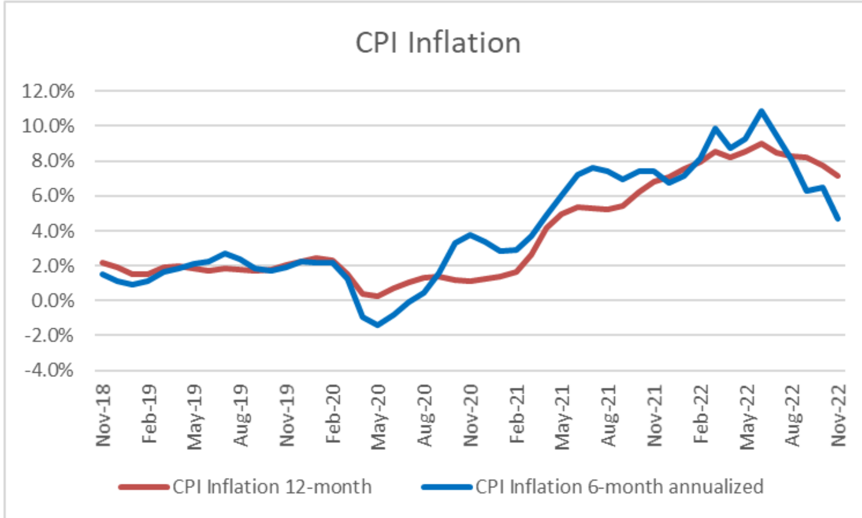
Fundamentals

Economy: Forecast: cloudy with a chance of recession

Yogi Berra said, "It's hard to make predictions, especially about the future." This quote is especially apt this year; the outlook is cloudier than usual given the number of uncertainties the world faces. The most pressing uncertainty involves the Federal Reserve and their potential to overtighten interest rates this year and tip the economy into recession. The conflict in Ukraine continues and there does not appear to be a quick face-saving resolution for Russia. While Europe's energy problems appear to be solved for this winter, the outlook for energy supplies to meet world demand is still uncertain and the potential for supply shortages and price shocks is still high. In addition, the risk of a mutant Covid strain causing another break out of infections still lurks as a possibility.

The contractionary monetary policy that the Fed adopted in March of last year is having its intended effect of slowing economic activity. GDP growth, which was expected by the Federal Reserve to be around 4.0% at the beginning of last year, looks like it will come in around 2.0% for the whole of 2022. Interest rate sensitive sectors like housing and durable goods have slowed precipitously and indicators of manufacturing have softened. In fact, many economic forecasters are predicting negative real economic growth or recession beginning later this year. In the technology sector, many companies have announced layoffs and reduced investment programs. Still, the majority of economic activity is in the services sector, and industries like travel, restaurants, and entertainment are still showing robust demand. For now, the economy appears to be growing, but the outlook is dicey.

The good news is that recent statistics show inflation is slowing. Hopefully the peak in inflation is behind us. Commodity prices have definitely turned down, with oil and gas prices more than 40% off their highs. Inflation as measured by the Consumer Price Index has also slowed. The year-over-year increase in the Consumer Price Index looks to have peaked in June of last year at 9.0% and the most recent year-over-year reading in November was 7.1%. (See graph on p. 2.) When looked at over smaller intervals, the rate of increase is slowing quickly, with prices over the past six months increasing at only a 4.7% rate, and over the past three months at only 3.7% (not shown).

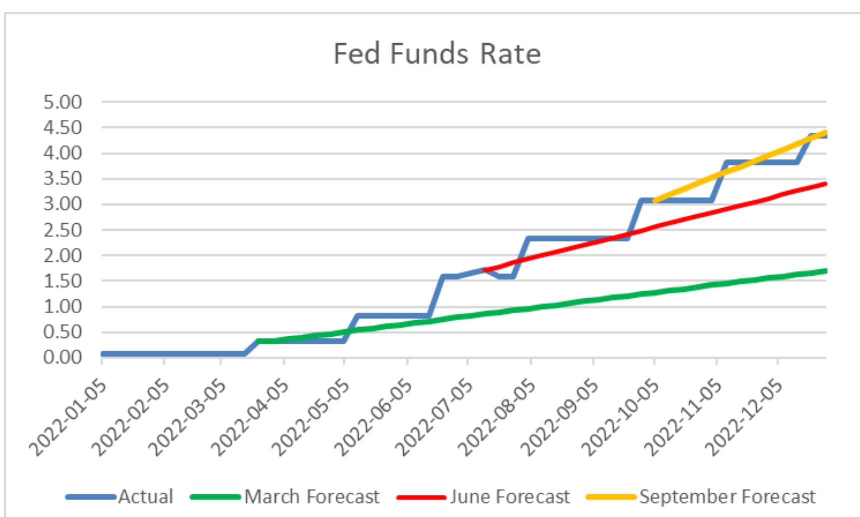


Source: U.S. Bureau of Labor Statistics

The area of the economy that the Fed is focused on most is the labor market since the way that inflation can become embedded in the economy is when wage increases lead to rising output prices. This can lead to a repeating cycle of rising wages and higher prices in what's known as a "wage-price" spiral. The labor market is cooling from the torrid pace it set in 2021. The economy continues to add jobs, but at a slower pace. Still, the unemployment rate has declined to 3.5% as of December, matching the low it hit before the pandemic, and by many metrics is tight. Wage inflation has slowed to 4.6% and appears to be on a downward trend from the 5.0%+ pace that it set earlier last year. The labor market appears to be too hot for the Fed's tastes and the Fed has signaled that it will continue its tight monetary policy until it is more convinced that the inflation monster is slain.

Federal Reserve: Talking tough

The Federal Reserve increased its target Fed Funds rate by 75 basis points in November and by 50 basis points in December. Fed Funds ended the year near the Fed's September estimate of 4.5%, well above what the Fed expected the Fed Funds to be back in its March and June prior forecasts. The Federal Reserve is also reducing the size of its balance sheet at a rate that should see its assets decline by $1 Trillion this year. They have stated that their goal is "return inflation to 2 percent over time" and will keep policy restrictive until they believe they have accomplished their goal.



Source: Federal Reserve

The Fed additionally published a forecast in December that predicts the Fed Funds rate to be near 5.1% at the end of 2023, and some Fed governors have commented that Fed Funds might go as high as 6.0% this year before falling. Right now, the yield curve predicts that rates will start to fall sometime in 2023, and longer-term Treasuries are currently well below shorter-term interest rates. So, bond investors are predicting that the Fed will be successful in getting inflation under control sometime this year, but whether the economy will suffer a recession in the process remains to be seen.

Corporate Profits: Estimates trimmed, but valuation improved

Ultimately, it is profits that drive stock prices and expectations for profit growth are moderating. Analysts trimmed estimates for company earnings throughout the summer to the point where fourth quarter earnings are expected to decline 2.8% compared to a year ago; this would mark the first time the index has reported a decline in earnings since Q3 2020 (on a year-over-year basis). Reasons cited have been slower economic growth, rising labor costs, continued disruptions from the supply chain, and strength in the dollar. S&P 500 companies earn about 40% of their revenues from overseas, and the dollar's sharp increase this year has depressed the earnings posted abroad. Energy is expected to show the largest gains in earnings; in fact, if the sector were excluded, the S&P 500 would be expected to post a decline in earnings of 7.3% instead of 2.8% this quarter. As of this writing, the S&P 500 is about 3890 and the earnings estimate for 2022 is $221 and for 2023 is $232, so it is trading at 17.6 times expected earnings this year falling to 16.7 times earnings next year; the 2023 figure is now below the PE average for the past 5 years (18.5) and 10 years (17.1) per FactSet. While the market valuation is lower, because interest rates are higher, Eagle's estimate of the equity premium is well below its historic average; this means the expected return for holding equities versus bonds is narrower than it has been in a decade.

Fixed Income: Yield curve inverts sharply

While short-term interest rates continued to rise following Fed rate increases, longer-term interest rates were stable in the quarter, leading to positive returns for many fixed income portfolios for the first time this year. For example, the one-year T-bill rate increased from 3.8% at the end of September to 4.7% at year-end while the 10-year Treasury bond started at 3.8% and ended the quarter at 3.9%. This meant that the yield curve inverted sharply during the quarter. Many have interpreted the low long-term interest rates to imply that bond investors believe that the Fed will get inflation under control, and perhaps tip the economy into recession in the process. In response to the greater possibility of an economic slowdown, we have increased the quality of our portfolios by reducing our exposure to corporates and increasing our exposure to governments and agencies. We have kept the maturities in our portfolios fairly short but are starting to increase them from low levels.

Stock and Portfolio Highlights

Eagle portfolios underperformed the S&P 500 Index during the quarter with technology holdings coming under pressure. Good stock selection in Financials, Industrials, and Consumer Discretionary were not enough to make up for difficult performances in the Information Technology and Communications Services sectors.

Purchases / Additions In The Quarter

American Tower Corporation (AMT): American Tower Corporation provides real estate investment services and owns, operates, and develops multi-tenant real estate properties. It operates in the U.S. & Canada, Asia-Pacific, Europe, Africa and Latin America. The sale and purchase of AMT was related to tax loss harvesting in our portfolios.

Fidelity National Information Services, Inc. (FIS): FIS is a leading global provider of banking, capital markets, payments technology solutions, processing services and information-based services. Positive characteristics include its stable and recurring revenues; good operating leverage and cash conversion; and attractive capital return. The company shares have been under pressure due to underperformance in its payments business. We believe the new management, expense controls, and recent activist interest is likely to lead to a shareholder friendly outcome.

Home Depot, Inc. (HD): We believe the trend to remote work is secular in nature and it will continue to support home improvement spend. Home Depot has stayed ahead of the curve in multichannel sales, with digital sales now accounting for 13-15% of total sales. The focus on professional customers is an additional differentiator for Home Depot and it is likely to continue to solidify its share in that segment.

Johnson & Johnson (JNJ): In 2023, Johnson & Johnson is separating its consumer health segment into an independent company leaving the Pharma and Medtech segments under the JNJ roof. From there, JNJ's strategic plan is to accelerate the Medical Device unit's growth trajectory through M&A and internal R&D investments while harvesting the Pharma’s blockbuster assets and strong pipeline. This should lead to strong growth for the two remaining franchises and the potential for more value creation through acquisition and divestments. With a strong balance sheet and AAA credit rating, we decided to increase our Health Care weight by adding to our position.

QUALCOMM Incorporated (QCOM): The sale and purchase of QCOM were related to tax loss harvesting in our portfolios. We believe QCOM's near future is tied to the macro trends in the smartphone market, while the medium-term outlook will be determined by advancements in the automotive and IOT (internet of things) markets.

Invesco PHLX Semiconductor ETF (SOXQ): The ETF was used as a holding place in order to monetize a portion of Qualcomm though our tax monetization strategy.

Sysco Corporation (SYY): Sysco Corporation is the largest global distributor of food and related products primarily to the foodservice or food away from home industry. Following a new CEO, in 2021 Sysco laid out its three-year road map, termed "recipe for growth" which focuses on cutting operating cost while also accelerating growth. As the company continues to execute on its plan and deliver share gains, we decided to add more to our position.

Sells / Trims In The Quarter

American Tower Corporation (AMT): American Tower Corporation provides real estate investment services and owns, operates, and develops multi-tenant real estate properties. It operates in the U.S. & Canada, Asia-Pacific, Europe, Africa and Latin America. The sale and purchase of AMT was related to tax loss harvesting in our portfolios.

Meta Platforms Inc. (META): The European Union privacy regulators ruled against Meta in a nearly 5-year-old complaint related to EU privacy regulations. The ruling has yet to be publicly released, but it points to a need for consent from users to show them personalized ads based on their activity on Meta platforms. In other words, while Apple privacy changes impacted access to third party data, this EU ruling is aiming at Meta's ability to use first party data (i.e. data from its own platform) to show personalized ads. The impact could be material given Meta generates 25% of its revenue from Europe. We sold Meta in response to this news.

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Salesforce, Inc. (CRM): We sold salesforce.com in anticipation of weak earnings. With growth materially decelerating next year to less than 10% revenue growth and low teens free cash flow growth, Salesforce's growth thesis has now broken apart. The muted growth trajectory and elevated stock-based compensation is unable to support existing valuation levels.

Schwab Strategic U.S. REIT ETF (SCHH): As part of our tax monetization strategy, we decided to sell the ETF and redeploy the proceeds into American Tower Corporation.

Thermo Fisher Scientific Inc. (TMO): Thermo Fisher Scientific, Inc. engages in the provision of analytical instruments, equipment, reagents and consumables, software, and services for research, analysis, discovery, and diagnostics in health care. We recently doubled our position in Q3 in order to monetize the loss lot in Q4 as part of our tax monetization strategy.

Disclosures