EAGLE GLOBAL ADVISORS

Market Review and Outlook

Q4 2018

EGA U.S. Equity

From the EGA Portfolio Management Team

Economic worries about a synchronized slowdown came to a head in the fourth quarter leading to a negative 13.6% return for the S&P 500. That turned what looked like a decent year for the index at the end of the third quarter into a negative 4.4% return for the year. Concerns about a slowdown in Europe, the trade dispute with China, and the resolution of Brexit hurt international equities; the MSCI EAFE Index declined 12.6% for the quarter, bringing its decline for the year to 13.8%. Long Treasuries rallied while short rates rose after the Fed hiked the Fed Funds rate in December. Corporate spreads widened on the back of economic worries, leading to mixed returns in fixed income.

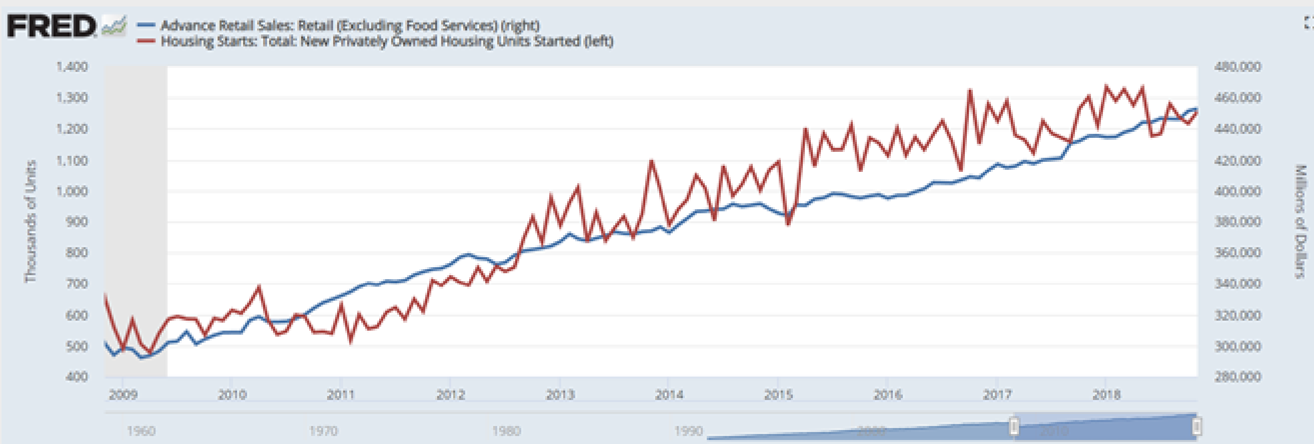
While we expect growth in the U.S. should slow from around 3% in 2018 to under 2% in 2019, we do not currently forecast a recession in the next 12 months. We believe the Fed, after raising interest rates for three years, has space to react stimulatively if further signs of a slowdown appear. Household and corporate balance sheets look healthy, and after the sell off in the stock market, valuations look well-grounded especially versus the growth in earnings that we expect for 2019 and 2020. With the decline in bond yields, we believe the outlook is for equities to outperform cash and fixed income in the coming year.

Economy: *Economic Growth Decelerates*

Real gross domestic product (GDP) increased at an annual rate of 3.4% in the third quarter of 2018, decelerating from 4.2% in Q2 2018. The increase in real GDP in the third quarter reflected positive contributions from personal consumption expenditures (PCE), private inventory investment, state and local government spending, federal government spending, and nonresidential fixed investment that were partly offset by negative contributions from exports and residential fixed investment.

U.S. November retail sales rose better than forecast, suggesting that consumer spending, the biggest part of the economy, continues to be robust. Americans took advantage of lower fuel prices and Black Friday sales that kicked off the holiday-shopping season last month, setting up household consumption for a stronger-than-expected quarterly increase following what were already the best back-to-back gains in four years. The value of overall sales rose 0.2 percent in November, topping forecasts, after an upward revision to the prior month. The so-called control group subset, which some analysts use to gauge underlying consumer demand, climbed 0.9 percent, the most in a year and more than double projections.

Housing market continues to give mixed signals. U.S. new-home construction rebounded in November to the best pace since August while permits rose to a seven-month high, a sign homebuilding is potentially stabilizing even as higher prices and borrowing costs pose headwinds. One weak spot was single-family starts, which fell 4.6 percent to an 824,000 pace. Starts for multifamily homes, a category that tends to be volatile and includes apartment buildings and condominiums, jumped 22.4 percent to a 432,000 rate. In an encouraging sign, permits rose 5 percent to a 1.33 million rate, topping estimates for 1.26 million and helped by gains for both single- and multi-family dwellings. The job market remains solid and mortgage rates are stabilizing after recently hitting a seven-year high. At the same time, builders face higher costs for labor and imported materials such as steel, reflecting the trade war, and demand also has cooled amid rising borrowing costs and elevated home prices. Sales of previously owned U.S. homes rose for a second straight month and exceeded forecasts in November, suggesting consumer demand is picking up as price gains are moderate amid more generous inventories. However, contract signings to purchase previously owned U.S. homes unexpectedly fell for a second month in November. The weaker results underscore the challenges as elevated prices and higher mortgage rates keep many Americans on the sidelines of the housing market. Economists consider pending-home sales a leading indicator because they track contract signings. Purchases of existing homes are tabulated when deals close, typically a month or two later.



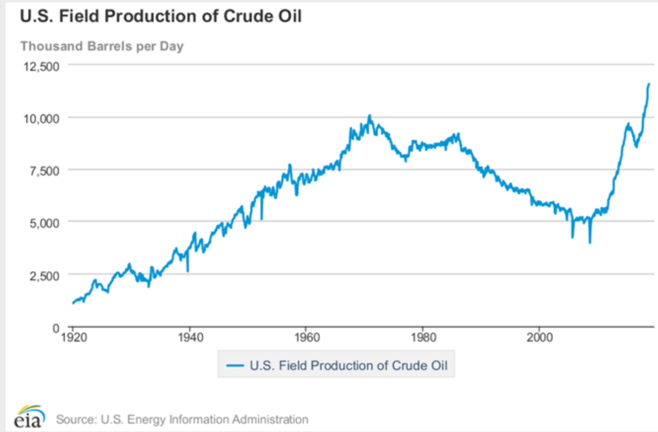
The ISM Manufacturing Index pulled back to 54.1 in December from a 14 year high reached in August, though it remains above the 50-point dividing line which separates expansion from contraction. The measure of new orders and the reading for production both eased to the lowest since 2016. Several manufacturers in the ISM report noted tariffs and higher prices have made operations less competitive, though just over a third of surveyed firms mentioned trade tariffs, down from the peak in November when that figure was 50 percent.

The conference board's Consumer Confidence Index fell to 128.1 vs. 136.4 in prior month, driven by a decline in consumer confidence expectations for future. Present situation confidence fell slightly to 171.6 vs 172.7 last month. Consumer confidence expectations fell sharply to 99.1 vs 112.3 last month. Additionally, the NFIB Small Business Optimism Index, a gauge of optimism among U.S. small-business owners, also fell in November to a lower than expected level.

U.S. jobs and wages rose by less than forecast in November while the unemployment rate held at the lowest in almost five decades, indicating some moderation in a still-healthy labor market. Average hourly earnings rose a healthy 3.1% versus last year. The jobless rate was unchanged at 3.7 percent in November. The U-6, or underemployment rate, rose to 7.6 percent from 7.4 percent. This measure includes part-time workers who want a full-time job and people who are less active in seeking work.

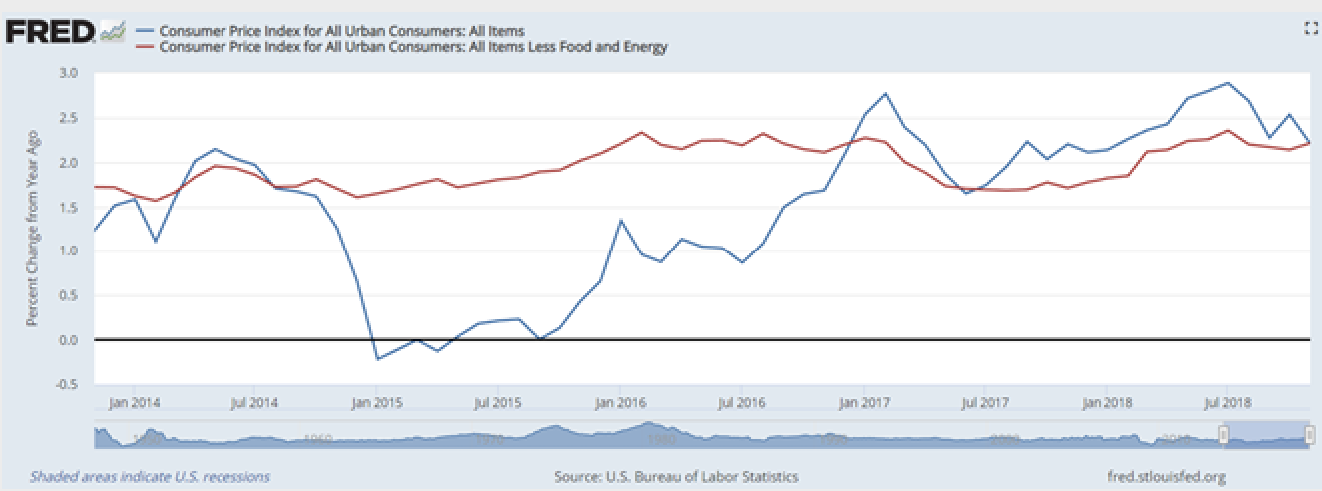
Oil: *Crude Oil Declines Sharply*

In Q4, the oil market was engulfed by fears of a global growth slowdown, as worries emerged that falling demand and robust output from major producers will lead to a supply glut. U.S. crude prices fell 38% from the end of September through the end of 2018 – the biggest quarterly slide since the final months of 2014. Swelling production figures out of the U.S., Saudi Arabia and Russia triggered the price slump during the fourth quarter, while unexpected sanction waivers by the Trump administration to buy Iranian crude compounded bearish sentiment. Oil prices continued to decline in the final weeks of the year, even after Organization of the Petroleum Exporting Countries (OPEC) in early December agreed to reduce output. A lack of resolution in the U.S.-China trade dispute also has prompted analysts to lower their price targets for oil. However, oil prices climbed at the start of the new year, in response to new supply data that suggested OPEC cuts are taking hold in the new year.



Inflation: *Eases Slightly*

U.S. consumer prices were unchanged in November, held back by a sharp decline in the price of gasoline, but underlying inflation pressures remained firm amid rising rents and healthcare costs. In the 12 months through November, the CPI rose 2.2 percent, slowing from October's 2.5 percent rise. Excluding the volatile food and energy components, the so-called core CPI increased 2.2 percent in November after climbing 2.1 percent in October. The shelter index increased 3.2 percent. The medical care index rose 2.0 percent over this span, as the hospital services index increased 3.5 percent. Several indexes decreased over the last 12 months. The communication index fell 1.7 percent over the span, and the indexes for apparel, lodging away from home, and airline fares also declined. The Federal Reserve's preferred inflation measure, the core PCE price index excluding food and energy, increased 1.8 percent year-on-year in October, the smallest gain since February, after rising 1.9 percent the prior month.



Corporate Profits: *Valuation Attractive Against Strong Profit Growth*

According to Factset, Q4 earnings for the S&P 500 Index are estimated to grow 11.4% versus last year. All sectors, excluding utilities, are expected to report year-over-year earnings growth, led by Energy, Industrials and Financials. With the S&P 500 Index currently near 2464, the Price-to-Earnings Ratio of the market is around 14 times the 2019 mean earnings estimate, slightly below its long-term average. Also supporting valuations is robust earnings growth expectations of 7.6% in 2019 and 11% in 2020.

Interest Rates: *A Shallower Path of Rate Hikes*

As expected, the FOMC raised interest rates for the ninth time in this cycle, moving the target range for the Federal funds rate up by 25 bp to 2.25%-2.50%. Officials now project two hikes next year, which is a reduction from prior forecasts but still ahead of current market pricing of no additional moves in 2019.

Fixed Income: *Yield Curve Continues to Flatten*

Short term rates during the quarter rose, anticipating the Fed's decision to raise its policy interest rate by a quarter point at its December meeting. However, concern over signs of an economic slowdown in the U.S. and abroad led to a significant decline in long term Treasury interest rates. The 10-year Treasury bond yield declined from 3.05% on September 30 to 2.68% on December 31. Economic worries also led to a widening of risk spreads in the corporate and especially the high yield areas of the fixed income market. At Eagle, our shorter duration exposure and exposure to investment grade corporate debt led to slight positive returns. Given our outlook for moderate economic growth for the U.S. from here, we are maintaining our current orientation to the fixed income markets.

Stock and Portfolio Highlights

Outperformers: Increased allocation to cash and outperformance of Healthcare sector supported overall performance relative to the benchmark.

Disappointments: Stocks in the Information Technology and Consumer Discretionary sectors lagged in performance relative to the benchmark.

Purchases / Additions In The Quarter

Amgen Inc.: Amgen is biotechnology company, which engages in the discovery, development, manufacture, and marketing of human therapeutics. Its products include the following brands: Aranesp, BLINCYTO, Corlanor, ENBREL, EPOGEN, IMLYGIC, KYPROLIS, Neulasta, NEUPOGEN, Nplate, Parsabiv, Prolia, Repatha, Sensipar, Vectibix, and XGEVA. The company trades at an attractive PE of 13x and has a yield of 3%.

Berkshire Hathaway Inc.: We increased our holding in Berkshire Class B holdings after the company reported strong earnings in the third quarter. Berkshire should benefit from strong earnings growth in the manufacturing, service, utilities and energy units and earnings growth in the Burlington Northern railroad business is experiencing a recovery. While near term earnings growth from insurance, primarily Geico, might be soft, they reliably generate over $20 billion in free cash flow per year. With over $100 billion in cash, and an attractive valuation relative to book value, Berkshire has indicated an increased willingness to repurchase stock. While the age of Warren Buffet is a concern, the valuation of the stock does not appear to reflect a "Buffet Premium".

Emcor Group Inc.: Emcor delivered a solid quarter with beats in most divisions and modestly raised guidance ahead of estimates both on the top-line and the bottom-line. It is a US-focused company and US non-residential market is still expected to remain strong through 2020. The industrial segment is past Harvey headwinds and outlook is improving, given massive petrochemical buildout.

Facebook Inc.: Aside from all the noise surrounding regulation and privacy, Facebook has retained its network effect of loyal users and advertisers who continue to generate above average ROIs on the platform. We believe that some form of regulation is now imminent, but do not expect that to reverse incremental ad budget flows into digital advertising or impact Facebook significantly more than its other digital media peers. At 16 times 2019 earnings, the stock more than discounts the expense ramp for 2019 while it is expected to grow revenue above 20% for both 2019 and 2020.

Purchases due to tax loss harvesting: Amazon.com, Caterpillar Inc., Chevron, EOG Resources Inc., Financial Select Sector SPDR, Invesco QQQ Trust Series 1, Lockheed Martin Corp, Philip Morris International Inc., Utilities Select Sector SPDR, VanEck Vectors Oil Services ETF.

Sells / Trims In The Quarter

Lowes Inc.: We exited Lowe's in the face of a potential housing downturn as well as high expectations set for the new management as it executes on its plan to catch up with competition. We believe Lowe's will have to guide the numbers lower and reinvest in the business to better compete with its peers, but so far they have chosen to do the opposite. Specifically, we believe Lowe's will find it hard to catch up with Home Depot in delivery without revising margins lower.

Micron Techology: Slowdown in end markets – specifically server and smartphones – was confirmed by softness in memory prices in a seasonally strong 3rd quarter. Knowing that cyclicality in memory chip prices increases when supply-demand normalizes, we decided to exit this position.

Arch Coal Inc.: Arch Coal, Inc. engages in the production and distribution of thermal coal. It operates through the following segments: Powder River Basin; Metallurgical; and Other Thermal. The Powder River Basin segment extracts thermal coal from the Upper Wyodak and Main Wyodak seams. The Metallurgical segment refers to Mountain Laurel, Beckley, Sentinel, and Leer operations. The Other Thermal segment consists of West Elk, Viper, and Coal-Mac mining activities. We believed $94 was a good price to exit Arch with recent downside in the low $80's and signs of weakness in the Metallurgical coal market we took profits.

Goldman Sachs Group Inc.: We sold Goldman given a weak FICC trading environment as well as the risks in terms of financial impact and reputational damage from the 1MDB scandal (the Malaysian sovereign fund). While the stock looks cheap, we don't see a catalyst for significant multiple expansion until the issue is resolved.

Sales due to tax loss harvesting: Halliburton, Wells Fargo, Altria, Raytheon, Bank of America, East West Bancorp, Morgan Stanley, Concho Resources, Qualcomm, VanEck Vectors Oil Services ETF, Visteon, Amazon.com, Caterpillar, DowDupont.