EAGLE GLOBAL ADVISORS

Market Review and Outlook
Q3 2018

EGA International Equity ADR
From the EGA Portfolio Management Team

Market Overview
Global equity markets climbed a wall of worry and ended the third quarter on a positive note. The MSCI EAFE Index rose 1.35% bringing its year-to-date return to -1.43%. In the U.S., the S&P 500 rallied during the quarter and registered a 7.71% return bringing its year-to-date return to 10.56%.

The Global Economy
Global Summary
In its July World Economic Outlook, the International Monetary Fund (IMF) kept its global growth expectations unchanged but stated that the "expansion is becoming less even, and risks to the outlook are mounting". The IMF noted increasing trade tensions could derail the global recovery. Don't tell that to the U.S. economy which remains on a steady path of strong growth this year with wage growth, employment gains, and business confidence all strong and leading to second quarter GDP growth at the highest level since 2014. The strong U.S. economy supports the interest rate increases from the Federal Reserve as they continued to increase rates at a steady pace. Yet, some economies outside the U.S have seen a moderate slowdown in recent months.

In its latest global economic assessment, the Organization for Economic Cooperation and Development (OECD) slightly lowered GDP forecasts for this year and next. It warned that trade tensions could hinder investments and slow the pace of expansion while noting that this was not the end of the recovery but that risks were increasing. The OECD specifically lowered its forecasts for the U.K. and Eurozone economies citing a lack of clarity on the way Britain would be exiting the European Union next year. The JP Morgan Global Composite PMI confirmed the slight decline in economic activity outside the U.S. with its output index reaching a 2-year low of 52.8. They stated that "the service economy fared a little better, with business activity rising at a faster pace than manufacturing production". Employment gains continued with job creation seen in the U.S., the Eurozone, Japan, and the U.K. while inflationary pressures remained as input price inflation stayed stubbornly high. Uncertainty has risen a bit given the global trade tensions and the survey notes that "signs that output growth at service providers may recover in the coming months are positive, although deteriorating outlook for international trade may entrench the lackluster performance of manufacturing."

The U.S. trade negotiations with China reached an impasse while gains were made in the NAFTA agreement. The U.S., Mexico, and Canada were able to reach agreement on a new comprehensive trade agreement. The new pact, coined USMCA instead of NAFTA, is a significant win for the Trump administration's goal of re-negotiating trade agreements it sees as unfair to the U.S. worker. The better than expected U.S. economic performance, together with rising interest rates and advancing trade negotiations, continued to support the U.S. Dollar versus major currencies globally during the quarter. The U.S. Dollar index has risen more than 3% for the year-to-date period.

Japan / Asia
Japan's second quarter economic growth registered a nice rebound, but the third quarter may show temporary contraction following natural disasters in the country that dented economic activity and trade routes. The Bank of Japan (BoJ) has maintained its promise to keep extremely low interest rates for an "extended period" while Prime Minister Shinzo Abe conceded in September that the BoJ's large scale monetary easing could not continue indefinitely. The path of policy normalization is surely to become a larger topic of discussion over the coming 12 months. The BoJ is expected to remain on the sidelines until at least after the consumption tax hike next year where VAT taxes are scheduled to rise from 8% to 10% in October of 2019.

Consumption remains sluggish in the country and inflation estimates for this year and next of 0.8% are well below the BoJ's goals of 2%. The Nikkei Japan Manufacturing PMI continues to expand at a robust pace but the average reading for the third quarter of 52.4 is notably weaker than those seen in the first and second quarters of this year. Yet, manufacturing appears to be faring better. The Nikkei Japan Services PMI shows the service economy barely in expansionary levels with the latest September PMI at 50.2. Some of the recent weakness may be temporary due to natural disasters during the third quarter and not a new trend.

Europe

While having slowed somewhat in recent months, Europe's' economic growth remains above trend. Both the OECD and the European Central Bank (ECB) recently slightly decreased their estimates for Eurozone economic growth for 2018 and 2019 but growth remains above trend growth. The IHS Markit Eurozone Composite PMI fell slightly to 54.1 in September with divergent trends as the service sector rose to a 3-month high while the manufacturing sector recorded its slowest rise in output since May 2016. Employment continued to be supported in the Eurozone and inflation pressures "remained sharp" and slightly higher than August. IHS Markit noted that "although running close to a two-year low, the disappointing September PMI remains at a relatively elevated level and signals solid growth."

With this solid growth underpinned, the ECB confirmed its plan to wind down its bond buying program by the end of this year and stated it was likely to hold its benchmark interest rate at a negative -0.4%, "at least through the summer of 2019." Market observers expect the first rate rise from the ECB to happen in September 2019, shortly before Mario Draghi's term ends at the ECB. According to Draghi, "household disposable income in the Eurozone is currently growing at the highest rates observed in the last 10 years", placing upward pressures in inflation. The ECB expects inflation of 1.7% in both 2018 and 2019 and GDP growth of 2% in 2018 and 1.8% in 2019, all above recent trends of the last decade.

The U.K. economy in contrast is feeling the uncertain effects of Brexit. With no resolution between the European Union and the British government on how Britain will exit the Union, business investment has stalled as uncertainty clouds economic prospects. Even with the higher uncertain-
-ty, the Bank of England increased rates for the second time as inflationary pressures and low unemployment trumped the Brexit uncertainty. GDP growth estimates for the U.K. have declined to 1.2% for 2018, below the 1.7% growth registered in 2017.

Emerging Markets

Confidence of emerging markets remained front and center in the quarter as trade tensions and rising interest rates placed additional pressures on currencies and sovereign debt yields in these economies. China went on the offensive with policy support during the quarter with both monetary and fiscal policy frameworks supporting the Chinese economy. The country announced new tax policies to support consumption growth as well as looser monetary policy to support lending as trade tensions with the U.S. are seen as a headwind to economic growth.

The rise in oil prices has pressured the current accounts of some economies such as Turkey and India, given they are large importers of oil. Currencies of both countries have suffered the consequences of a deteriorating current account. In Turkey's case, the dispute with the U.S. over a jailed U.S. pastor as well as aggressive credit growth over the last twelve months has come home to roost. Markets loss of confidence in the Turkish central bank led to significant depreciation of the currency as politics overruled common sense in Turkey's handling of the economy. While it was hard to imagine that things could get any worse in Venezuela, it appears they have. The government devalued the currency by 96% and raised wages by nearly 6,000% likely pushing inflation even higher than the 1,000,000% forecast for this year by the IMF. This disastrous economic experiment has led to widespread shortages of food, medicine, and clean water and pushed more than 2.3 million Venezuelans to flee to neighboring countries since 2014.

Politics

Japanese Prime Minister Shinzo Abe was re-elected as head of his ruling Liberal Democratic Party (LDP), paving the way for up to three more years as prime minister. Abe won roughly 70% of the vote and that may embolden him to pursue changes to Japan's constitution. In Europe, U.K. Prime Minister Theresa May was unable to convince the European Union on its latest Brexit proposal as both sides remain far apart on the subject of Northern Ireland and trade. The U.K. is scheduled to exit the EU in March of 2019 and Brexit talks at an impasse place significant uncertainty on the Brexit outcome.

Populist efforts continued to be supported in Europe as Sweden's election ended in a near dead-heat between parties on the left and right but emboldened the anti-immigration Sweden Democrats which increased its support the most of all parties. It could take weeks or months to form a new government. The election eventually led to a no confidence vote that ousted Prime Minister Stefan Lofven although he will stay on a transitional government while a new government is sorted out. Italy's government also tried to flex its populist agenda by announcing a new budget that does not conform to agreements made with the European Union. These populist movements are sure to provide fuel to the fire as European Parliament elections approach in May of 2019.

Stock and Portfolio Highlights

Monetary policy normalization is still sending ripples through equity and bond markets globally. As the U.S. economy remains on firm footing and the Federal Reserve continues to raise rates, emerging markets are feeling the brunt of the punch bowl being taken away. Even though global monetary conditions remain accommodative, with the change in policy comes volatility. Emerging market currencies continued to depreciate in the quarter led by the Turkish Lira which was pummeled following tensions with the U.S. but more so on lost confidence in the independence of its central bank. Other emerging currencies also suffered with the volatility as trade tensions between China and the U.S. worry some that these countries will suffer the economic consequences of trade dislocations. The U.S. maintained its pressure on China by announcing an additional 10% tariff on $200bn worth of goods from China with the Chinese government striking back with tariffs of its own. Analysts suggest the Chinese government is waiting until after the U.S. mid-term elections to gauge their negotiating stance. The Trump administration did have a trade win as Canada and Mexico agreed on a new NAFTA trade agreement providing a boost to the president's negotiating tactics.

Market jitters surfaced again late in the quarter as trade tensions and the direction of interest rates worried investors. Rising rates in the U.S., where the 10-year government bond rose above the 3.2% mark for the first time since 2011, concerns equity markets about the effect of rising rates on the economic recovery. Some worry over the potential of an inverted yield curve sometime in 2019 as the Federal Reserve continues to raise rates. While rates have risen, the Iran sanctions and Venezuela's plummeting oil production have taken oil supplies off the market, leading to higher oil prices in the quarter. Earnings growth overall remain well underpinned globally by stronger than trend economic growth. International equity valuations, amid the stronger earnings growth, appear supportive for positive equity returns over the coming year.

Large caps outperformed small and mid caps for the quarter while mid caps remain slightly ahead for the year-to-date period. Growth outperformed value in the quarter as growth extended its lead for the year. The best performing MSCI EAFE countries for the quarter were Switzerland, Sweden, and Norway, while the worst performers were Ireland, Belgium, and Italy. The best performing emerging markets for the quarter were Thailand, Qatar, and Poland, while the worst were Turkey, Greece, and China.

Outperformers: Eagle portfolios slightly outperformed the MSCI EAFE Index for the quarter. Good stock selection in the Telecom Services, Industrials, and Health Care sectors supported the outperformance. Country selection was good in Japan, Switzerland, and Spain. Softbank, the telecom services company in Japan and Lonza, the health care company from Switzerland were two of the best attributors to the portfolio for the quarter.

Disappointments: The main disappointments for the quarter were in the Information Technology and Consumer Discretionary sectors. Disappointment in Information Technology was mainly the portfolio's exposure to Chinese internet names that underperformed during the quarter. In Consumer Discretionary, two themes hurt the portfolio, with Macau gaming exposure and auto parts both suffering in the latest quarter. Exposure to emerging markets was a negative for the quarter as EMs underperformed developed markets.

Purchases / Additions in the Quarter

Ashtead Group PLC (ASHTY): SECTOR: Industrials; COUNTRY: United Kingdom: We added to our position in Ashtead, the U.K.-based and second largest equipment rental company in the U.S. with its Sunbelt brand. Non-residential construction in the U.S. is rebounding and the company is benefitting from cyclical trends. Ashtead continues to gain market share with the industry's youngest fleet and recent results confirm this trend.

Canadian Pacific (CP): SECTOR: Industrials; COUNTRY: Canada: We added to this position as Canadian Pacific sees brighter earnings prospects from better than expected crude by rail volumes, increasing market share, and a better demand environment with strong pricing. Good operating leverage and strong free cash flow are allowing CP to repurchase shares.

Melco Resorts & Entertainment (MLCO): SECTOR: Consumer Discretionary; COUNTRY: Hong Kong: Softness due to concerns over effects of Chinese trade battles with the U.S. gave us an opportunity to add to this name as execution in the mass market business in Macau is stellar. While low margin VIP business has seen some slowdown, higher margin mass market remains robust leading to very high free cash flow yield.

Prada SpA (PRDSY): SECTOR: Consumer Discretionary; COUNTRY: Italy: Prada is emerging from a major two year period of investment and transformation with strong sales acceleration in the first half of the year. We believe this marks an important inflection for the business as brand investments begin to pay off as margins recover.

Roche Holdings (RHHBY): SECTOR: Health Care; COUNTRY: Switzerland: Recent company results are supportive of positive earnings momentum. Roche's drug pipeline continues to support the erosion from biosimilar competition and we believe the positive momentum is not reflected in market expectations for the company.

Shiseido Co Ltd (SSDOY): SECTOR: Consumer Staples; COUNTRY: Japan: This well-known global cosmetics brand company based in Japan has seen good results from a restructuring plan to cut underperforming SKUs, to increase e-commerce sales, to add new talent, and to expand customer base. Brand growth and ecommerce growth have been strong in both Japan and China.

Sells / Trims in the Quarter

British American Tobacco SECTOR: Consumer Staples; COUNTRY: United Kingdom: Cigarette volumes remain under pressure as a continued secular trend while recent market share gains of e-vapor products dominated by non-incumbent companies, places added pressures on company margins and sales.

Sabesp (SBS): SECTOR: Emerging Markets-Utilities; COUNTRY: Brazil: Weaker than expected economic growth will affect trend growth for the company while a weaker currency is detrimental to the company given the company's foreign denominated debt. In addition, recent regulatory rulings that were below expectations hurt ongoing returns on capital for the company in the coming years.

Subaru Corp (FUJHY): SECTOR: Consumer Discretionary; COUNTRY: Japan: We exited this position as the company's new models appear to not be compensating enough to offset models entering sunset. In addition, concerns over possible tariffs would be very detrimental to Subaru at a time when management's execution has been disappointing.