Market Review and Outlook

Q2 2019

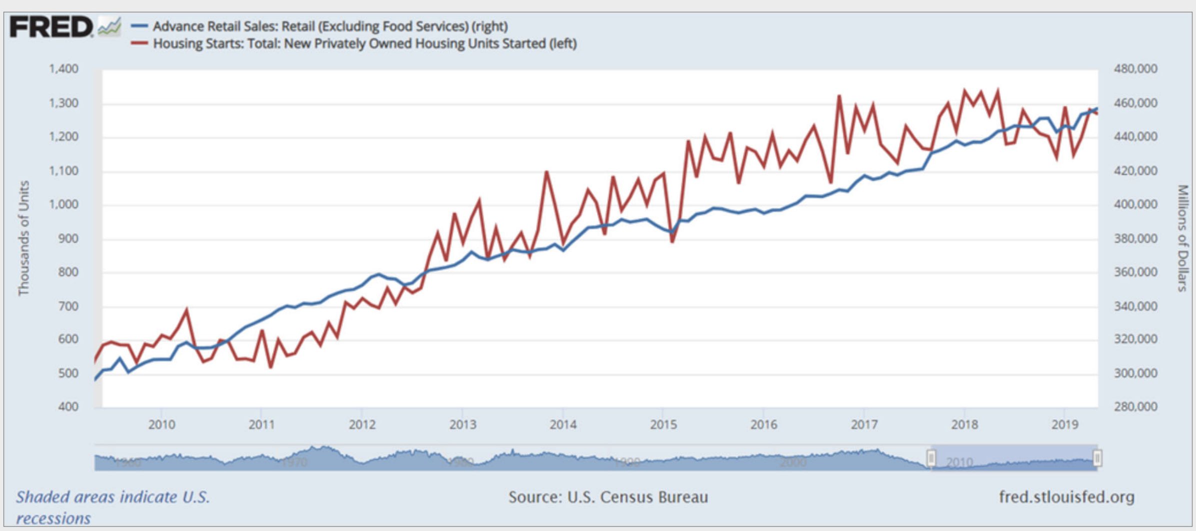
EGA U.S. Equity

From the EGA Portfolio Management Team

The S&P 500 Index rose +4.3% during the second quarter and reached a record intraday high level of 2,977 on July 1, 2019. The market rally continued to benefit from a reversal in monetary policy direction by the Federal Reserve and additional easing by the European Central Bank, Bank of Japan, China, Russia, and Reserve Bank of Australia (RBA). The U.S. and China trade negotiations deteriorated in May pushing markets lower only to be put on pause by the G20 meeting between President Trump and Chines President Xi Jinping. So far, the market seems to have brushed aside a recession warning from the inverted U.S. treasury yield curve and soft macroeconomic data.

Economy: *After Strong First Quarter, Economy Softens In The Second Quarter*

While the final numbers on growth in the first quarter were upgraded to a robust 3.1% over the fourth quarter of last year, the second quarter has exhibited a notable softening in economic indicators. A good part of the growth in the first quarter now appears to be an increase in inventories; final sales to domestic purchasers increased at a weak 1.6% pace. Subdued consumer spending has continued into the second quarter while business investment, which was strong in the first quarter, has showed signs of softening in the second quarter. Both could be reflecting heightened concerns over possible trade wars with our biggest trading partners, China and Europe.



U.S. May retail sales rose 0.5%, slightly below consensus estimate of 0.6%. Sales in the "control group" subset, which some analysts view as a more reliable gauge of underlying consumer demand, climbed 0.5%, topping projections. The measure excludes more volatile items like food services, auto sales, gas stations and building materials.

Housing data continues to be mixed. Contract signings to purchase previously owned U.S. homes (i.e. pending home sales) increased in May, indicating Americans may be responding to declining mortgage rates. While housing starts fell 0.9% in May, driven by weakness in single family starts, building permits rose 0.3%, indicating optimism for future housing construction. Lastly, while home price appreciation continues to decelerate moderately, sale of existing homes accelerated in May, beating consensus expectations.

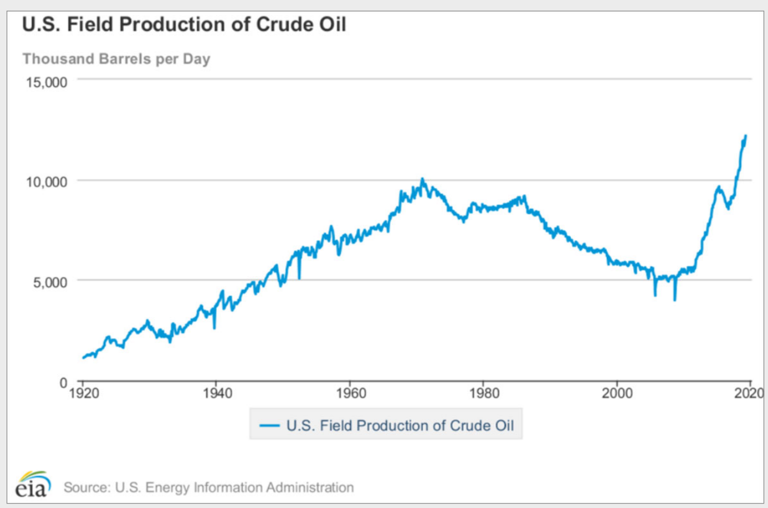
The manufacturing sector came under pressure in Q2, due to uncertainties surrounding the trade tariffs. The Institute for Supply Management manufacturing index dropped to 51.7, the third straight decline and the weakest level since October 2016. The measure of new orders fell to 50, the lowest since December 2015 and equaling the dividing line between growth and contraction. The data is consistent with other reports showing widespread weakness in manufacturing from Europe to Asia.

In May, U.S. employers added the fewest workers in three months and wage gains cooled, suggesting broader economic weakness and boosting expectations for a Federal Reserve interest rate cut. However, strong job growth rebounded in June to 224,000 beating expectations of 165,000 running contrary to worries that both the employment picture and overall growth picture were beginning to weaken.

U.S. consumer confidence fell in June to the lowest level since September 2017 as Americans became less upbeat about the economy and labor market amid trade tensions. However, optimism among small U.S. businesses rose to a seven-month high in May as companies increased capital spending plans, suggesting firms remain confident economic growth will continue. The National Federation of Independent Business optimism index increased 1.5 points to 105.

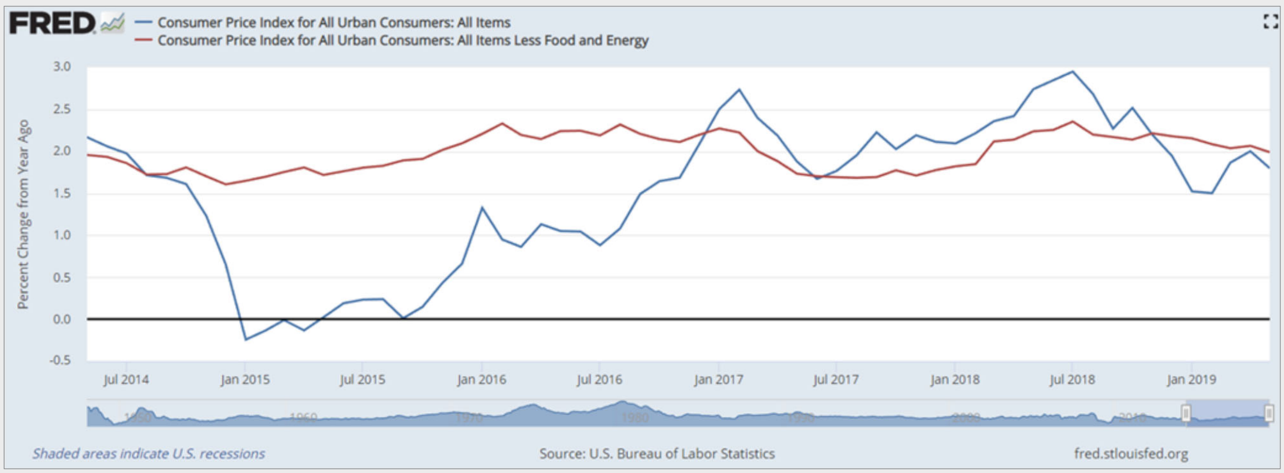
Oil: *Crude Oil Retreats*

Crude oil prices slumped at the start of the quarter, but recovered most of the losses toward the end, finishing down 2.8% at $58 for WTI and $67 for the Brent Index. During the quarter, U.S. crude futures sank more than 20% below their April peak on signs of a cooling global economy and plentiful supply. IEA downgraded its forecast for global oil demand for a second straight month in June. IEA cited weak global trade growth, a warm Japanese winter and a weakening European petrochemicals industry as reasons for the downgrade. U.S. production grew 2.1% in April to a record 12.16 million barrels a day. In June, Iran's Revolutionary Guard shot down a U.S. drone hours after a Saudi desalination plant was struck by a missile. Prior to that oil prices received a sharp boost from attacks on two tankers in the Gulf of Oman, which neighbors the Strait of Hormuz - the thoroughfare for a third of the world's shipped oil. While these events helped stage a recovery in oil prices, absent continuation of geo-political tensions, the sustainability of this recovery is in question.



Inflation: *Eases Slightly*

U.S. inflation trailed forecasts in May, reinforcing the case among investors for the Federal Reserve to cut interest rates. The core consumer price index, which removes energy and food costs, rose 2% from a year earlier, according to the Labor Department report. Economists had predicted a 2.1% increase. Core prices rose 0.1% from the previous month for a fourth straight time, missing estimates of a 0.2% gain. The broader CPI increased an annual 1.8%, less than projected. A sharp drop in used car prices helped drive the monthly change, while cheaper gasoline played a role in keeping broader inflation tame. However, the Federal Reserve's preferred measure of underlying U.S. inflation showed signs of picking up in May toward the central bank's goal. The core personal consumption expenditures price gauge, which excludes food and energy, rose 0.2% from the prior month and 1.6% from a year earlier. The annual gain was just above the median estimate and the three-month annualized increase advanced to about 2%, a five-month high.



Corporate Profits: *Profit Growth Cools*

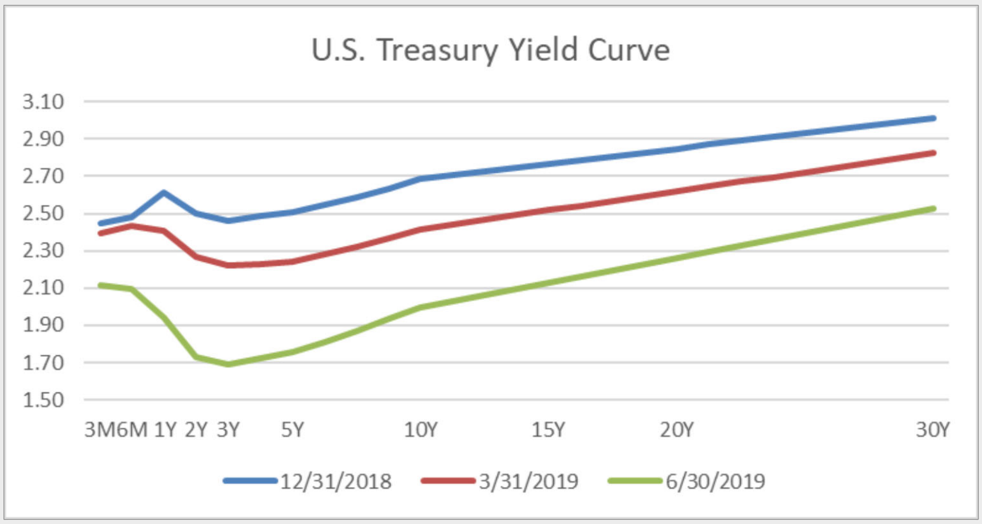
After benefitting from corporate tax reform in 2018, earnings are set to decelerate from 24% growth in 2018 to 2.4% in 2019. The estimated year-over-year revenue growth rate for Q2 2019 is 3.8% and 4.4% for the full year. The estimated year-over-year earnings growth rates are expected to decline -2.6% in Q2 2019, -0.5% in Q3 2019 and then grow +6.3% in Q4 2019. The forward 12-month P/E for the S&P 500 Index is 16.6x, which is slightly higher than the 5-year average of 16.5x and above the 10-year average of 14.8x.

Interest Rates: *Rate Cut Likely In July*

At its June meeting, the Federal Open Market Committee (FOMC) decided to maintain the current target range for the Federal Funds rate at 2.25%-2.50% while strongly suggesting an inclination to cut rates in the months ahead. The Fed's new dot plot suggests that 8 of 17 voting members forecast a cut of 25bp in 2019, while 7 of those 8 dovish members see a 50bp cut. That was an about face from the March meeting in which all members projected status quo or a rate hike. The current Fed Funds rate futures market is projecting a definitive rate cut at the July meeting.

Fixed Income: *Bond Yields Dip*

The U.S. 10-year note continued its precipitous decline in the second quarter, with the current yield falling slightly below 2.00% in the early days of July. That compares with 2.42% at the end of March and 2.68% at the end of 2018. Concerns about a slowing economy, low inflation, and extremely low interest rates abroad all contributed to the decline. Rising expectations for Fed rate cuts have been reflected in a larger drop for the 2-year Treasury, which has fallen from 2.50% at the end of 2018 to 1.73% at the end of June. This has led to an inverted yield curve at the short end of the maturity scale. Eagle fixed income portfolios have risen in line with most fixed income indices. Our portfolios have been negatively impacted by their relatively shorter maturities, but our higher exposure to credit spreads, which have stayed relatively stable, have benefited the portfolios.



Source: Factset, Eagle Global Advisors

Stock and Portfolio Highlights

Eagle portfolios outpaced the S&P 500 Index in the second quarter and are in line with the index for the year. Stock selection was positive for Industrials, Information Technology, Energy and Consumer Discretionary, and negative for Financials, Consumer Staples, Health Care and the Materials sectors. Sector allocation was neutral with Health Care, Financials, Real Estate, and Consumer Staples under-weight helping returns and cash dragging down returns.

Purchases / Additions In The Quarter

Amazon.com Inc. (AMZN): Amazon's disruption of the retail industry is well documented, but the company continues to find ways to evolve its business model. Its operational efficiency, network effect, and a brand intangible asset built on customer service provide its marketplaces with sustainable competitive advantages that few, if any, traditional retailers can match.

Emcor Group Inc. (EME): Emcor's original thesis continues to play out as the company executes well in a strong market. News of acquisition interest from French utility Engie added another pillar to our investment thesis, leading us to increase the position.

EOG Resources Inc. (EOG): We opportunistically added to EOG after the shares had underperformed U.S. energy peers. The underperformance offered an opportunity to add to our exposure to EOG, a company which we believe offers the best geological and operational outlook in the U.S. energy space.

Invesco QQQ Trust (QQQ): This ETF tracks the Nasdaq-100 Index, which provides access to some of the world's most innovative companies. The ETF only invests in nonfinancial stocks listed on NASDAQ. QQQ has large tech exposure, but it is not a 'tech fund' in the pure sense either. In all, QQQ delivers a popular combination of tech, growth and large-cap exposure with year-to-date performance exceeding the S&P 500 and an expense ratio of 0.2%. Eagle prefers to invest in the QQQ rather than cash while we evaluate companies for purchase. The opportunistic sell of Carnival provided the cash to invest in QQQ in June.

Select Sector SPDR TR (XLU): This ETF tracks utilities companies that are included in the S&P 500. XLU is among the cheapest and most liquid utility index ETFs available. Eagle decided to increase our portfolio exposure to Utilities with the purchase of XLU and decrease our portfolio exposure to Financials with the sale of XLF. The inversion of the Government fixed income yield curve, pivot by the Federal Reserve Board of Governors from tight monetary policy to potentially loose monetary policy, and other signals the Federal Funds rates are more likely to decline than rise prompted Eagle to reduce our Financials exposure and increase our Utility exposure.

UnitedHealth Group Inc. (UNH): The recent worries about Washington taking over all of health care provides an attractive opportunity to realize the loss on our high cost CVS/Aetna and switch to UNH, a lower leverage higher quality Health Care Maintenance Organization. UnitedHealth Group, Inc. is the largest private provider of health care coverage, software, and data consultancy services in the U.S. UNH trades at a more attractive valuation than its 5 year average and pays an attractive yield. Risk to all Health Care Maintenance Organizations include Medicare for All, Loss of Rebates, and ACA litigation. UNH doesn't have much exposure to ACA (except some modest Medicaid expansion exposure). In Eagle's view proposals for extreme restructuring of the private provision of U.S. healthcare services will be difficult to enact in Congress.

Sells / Trims In The Quarter

Carnival Corp. (CCL): We exited Carnival prior to its disappointing earnings report. Our trackers suggested that industry pricing had begun to weaken in May and June. Additionally, weak macro data points such as consumer confidence and home price appreciation flagged warning signs about consumers' appetite for cruise vacations which require long planning and upfront commitment. Lastly, Carnival had demonstrated higher than average execution risk following a series of earnings disappointments in the prior two quarters.

CVS Health Corp. (CVS): The recent worries about Washington taking over all of health care provides an attractive opportunity to realize the loss on our high cost CVS/Aetna tranche and switch to UNH, a lower leverage higher quality Health Care Maintenance Organization. The company issued $40 billion of debt to fund the acquisition of the health insurance provider Aetna Inc. The company lowered its earnings guidance for 2019. We have concerns about integration risks and the company's higher leverage given the competitive landscape. We are maintaining a small position with a gain and are looking for improvement in 2020.

Financial Select Sector SPDR (XLF): This ETF tracks Financials companies included in the S&P 500. XLF ETF is large, liquid, and outpaces its peers in trading volume. Eagle decided to decrease our portfolio exposure to Financials with the sale of XLF and increase our portfolio exposure to Utilities with the purchase of XLU. The inversion of the Government fixed income yield curve, pivot by the Federal Reserve Board of Governors from tight monetary policy to potentially loose monetary policy, and other signals the Federal Funds rates are more likely to decline than rise prompted Eagle reduce our Financials exposure and increase our Utility exposure.

PPL Corp. (PPL): As political turmoil has continued in the U.K., the odds of a general election have risen and polls show the Labour Party gaining popularity. As Labour gained ground, they further set out plans to nationalize the U.K. grid system should the party come to power. While U.K.-based utilities sold off on the news, PPL held firm, allowing us to dispose of the shares and mitigate a potential future risk.