EAGLE GLOBAL ADVISORS

Quarterly Commentary
Q3 2019

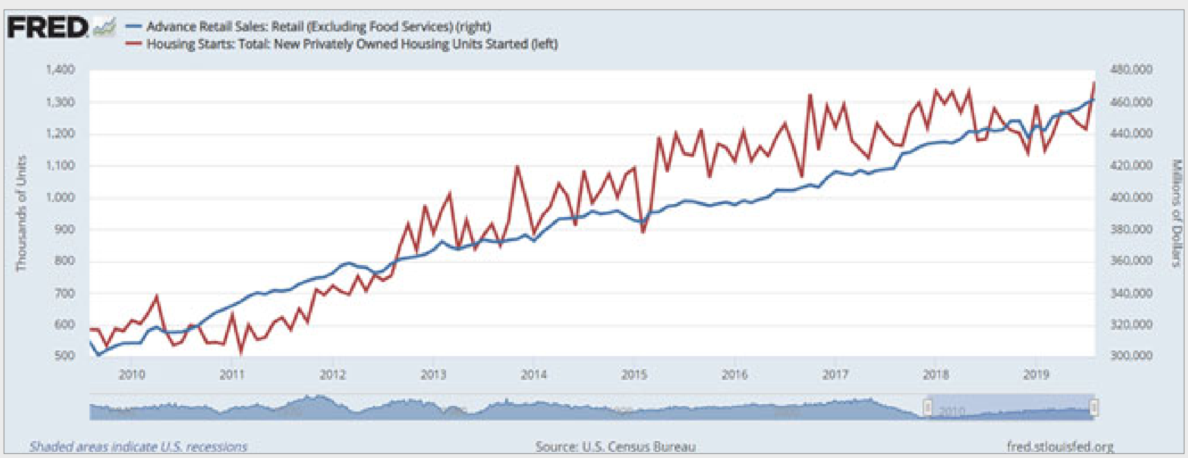
EGA U.S. Equity

From the EGA Portfolio Management Team

The S&P 500 Index rose +1.7% during the third quarter, helping stocks hold on to their biggest year-to-date gains (+20.6%) in more than two decades and prolonging the longest bull market on record. The advance this year comes alongside big rallies in both bonds and commodities. The concurrent rise in historically safe assets like Treasuries alongside riskier bets like stocks highlights the uncertainty investors feel about the global economy, the state of trade talks with China and the Federal Reserve's path of monetary easing. Despite this unease, investors see few alternatives to stocks as the amount of negatively yielding debt around the world continues to rise.

Economy: *Economic growth decelerates*

GDP growth in the second quarter decelerated to 2.0% from 3.1% in the prior quarter. While personal consumption rose 4.6% in the second quarter after rising 1.1% in the prior quarter, nonresidential fixed investment or spending on equipment structures and intellectual property fell 1.0% in Q2 after rising 4.4% in Q1.



U.S. retail sales rose 0.4% from a month earlier in August 2019, following a revised 0.8 % increase in July, driven by a jump in auto buying and healthy online sales. But there were also signs that consumers have become more cautious. Excluding automobiles, gasoline, building materials and food services, retail sales were 0.3% higher in August after a 0.9% advance in July.

Housing data improved in the quarter. U.S. housing starts jumped 12.3% from a month earlier to a seasonally adjusted annual rate of 1.36 million units in August 2019, the highest level since June 2007, likely supported by lower mortgage rates. Single family homebuilding increased 4.4% and starts for the volatile multi-family housing segment soared 32.8%. Building permits rose 7.7% from a month earlier to a seasonally adjusted annual rate of 1.42 million units, the highest level since May 2007. Contracts to buy previously owned homes in the U.S. jumped 2.5% in August from a year earlier.

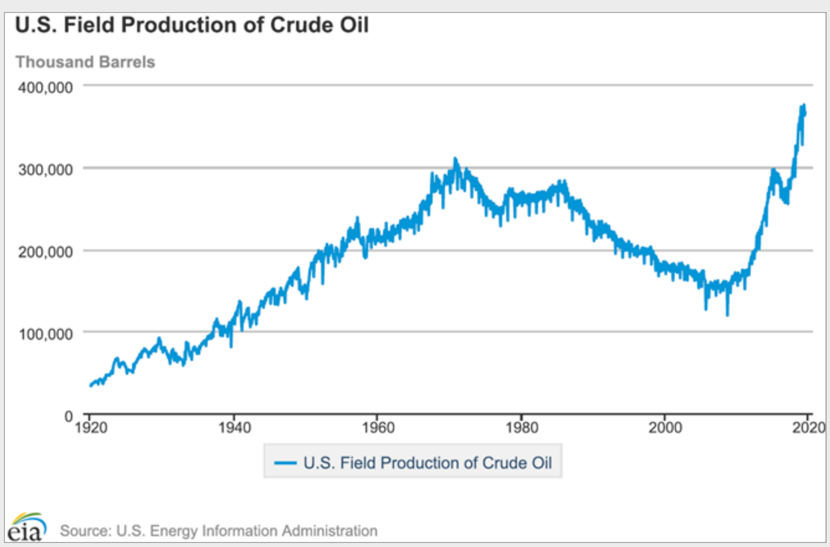
The manufacturing sector remained under pressure in the third quarter, due to uncertainties surrounding the trade tariffs. The U.S. manufacturing purchasing managers' index from the Institute for Supply Management came in at 47.8 in September, the lowest since June 2009, marking the second consecutive month of contraction. The new export orders index was 41, the lowest since March 2009, down from the August reading of 43.3.

U.S. employment grew only modestly as the economy added 130,000 jobs in August. The August tally was propped up in part by the addition of 25,000 temporary Census Bureau workers by the U.S. government, while estimates of payrolls in June and July were revised down. Meanwhile, wages are holding up after slowing a bit in the Spring. Average hourly earnings climbed 3.2% from August 2018, enough to keep worker earnings well above the inflation rate. The pay measure has now been above the 3.0% threshold for more than a year after lagging for much of the expansion. The unemployment rate was unchanged at 3.7% in August for the third consecutive month. The labor force participation rate edged up to 63.2%. The U-6 or underemployment rate, increased to 7.2% from 7.0%.

The Conference Board Consumer Confidence Index decreased in September, following a slight decline in August. The Index now stands at 125.1, down from 134.2 in August. The escalation in trade and tariff tensions in late August appears to have rattled consumers. Additionally, the NFIB Small Business Optimism Index fell 1.6 points from the previous month to 103.1 in August 2019, as fewer small business owners said they expect better business conditions and real sales volumes in the coming months.

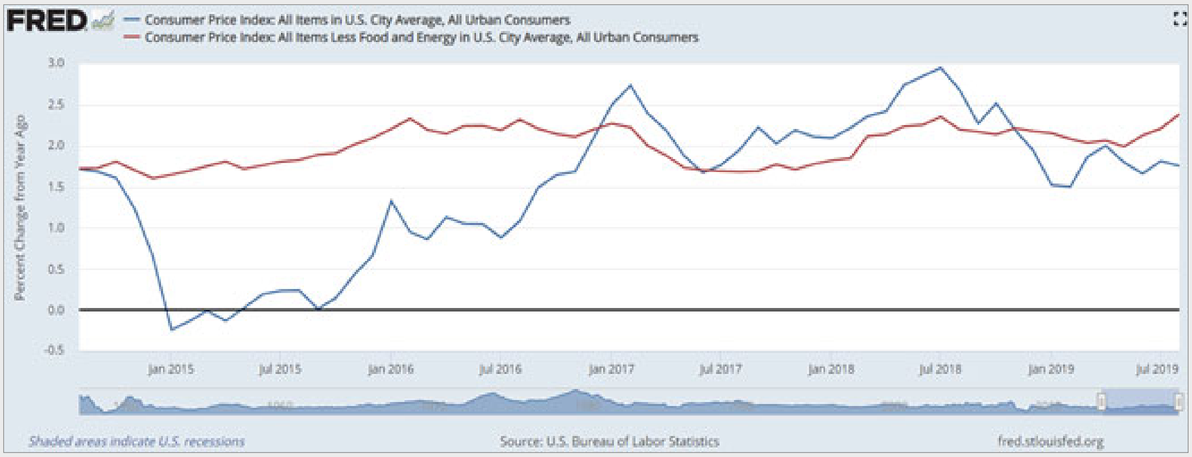
Oil: *Crude oil retreats*

Oil prices retreated as concerns over a global economic slowdown overshadowed an unprecedented attack on Saudi Arabia's key energy facilities. Brent futures declined 8.7% since the end of June, while WTI lost 7.5%, closing at $61 and $54 respectively on September 30th. Political tensions have abated somewhat since the September 14th drone strikes on the Abqaiq processing facility and Khurais oil field in Saudi Arabia. These attacks disrupted 5.7 million barrels a day of oil production or roughly 5.0% of the world's total supply. Brent crude futures soared 15.0% to $69 on the day of the attack, but the gains fizzled within days as Saudi Arabia began restoring production at a faster than expected pace.



Inflation: *Core inflation exceeds forecast*

Core U.S. inflation, which excludes volatile categories such as food and energy, accelerated by more than forecasted to a one-year high in August, signaling inflation was already firming ahead of fresh tariffs on Chinese goods. The core Consumer Price Index rose 2.4% from a year earlier following the biggest monthly rise in medical care costs since 2016 and record increases in health insurance prices. Sustained increases in inflation could give some Federal Reserve policy makers pause as they weigh additional interest rate cuts this year. So far, the Federal Reserve's preferred measure of underlying inflation - core personal consumption expenditures (PCE) – has remained below central bank's target of 2.0%. Year-on-year, the August core PCE Index went up 1.8%, in line with market expectations.



Corporate Profits: *Profits rebound in Q4*

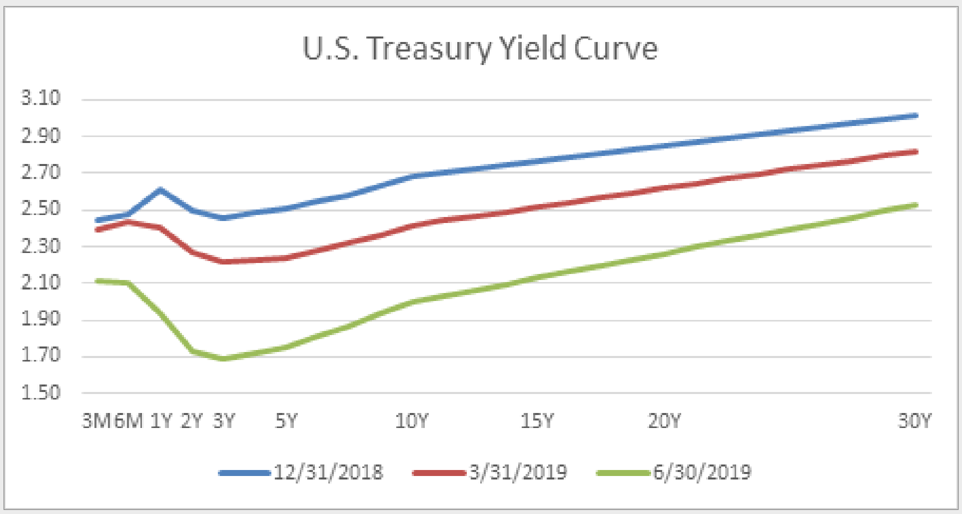
After benefitting from corporate tax reform in 2018, earnings growth is set to decelerate from 24.0% in 2018 to 1.3% in 2019. The estimated year-over-year revenue growth rate for Q3 2019 is 2.8% and 3.6% for the full year. The estimated year-over-year earnings growth rates are expected to decline -3.8% in Q3 2019 and then grow 2.7% in Q4 2019. The forward 12-month P/E for the S&P 500 is 16.8x, which is about even with the 5-year average of 16.6x and above the 10-year average of 14.8x.

Interest Rates: *Market expects a rate cut in October*

The Federal Open Market Committee (FOMC) decided to cut the federal funds rate target range by 25bp to 1.8%-2.0%, marking the second 25bp rate reduction this year. According to the Fed's "dot plot" of individual expectations, five members thought the FOMC should have held its previous range of 2.0% to 2.3%, five approved of the 25bp cut but keeping rates there through the rest of the year, and seven favored at least one more cut this year. The committee again cited "the implications of global developments for the economic outlook as well as muted inflation pressures" as the primary rationale for cutting the rate. In response to recent weak macroeconomic data, market expectations have risen for another rate cut in October.

Fixed Income: *Bond yields dip*

Interest rates continued their decline in the third quarter as evidence indicating an economic slowdown accumulated and the Federal Reserve reduced policy interest rates. The 10-year yield began the quarter at 2.0%, declined to a low of 1.5% in early September before rising to 1.7% at the end of the quarter. That compares with 2.7% at the end of 2018. In September the Fed lowered its benchmark overnight lending rate to a target range of 1.8%-2.0% from 2.0%-2.3%. Expectations are that they will lower this rate one more time by the end of this year. The yield curve has continued to be inverted at the short end of the maturity scale with the two-year note yielding below the three-month Treasury bill. However other measures of the yield curve, specifically the 10-year minus the two-year is still positive. Eagle fixed income portfolios have risen in line with fixed income indices. Our portfolios have had a higher exposure to credit spreads which has benefited the portfolios. Recently however we have cut our exposure to corporate credit and increased our exposure to Treasuries.



Source: Factset, Eagle Global Advisors

Stock and Portfolio Highlights

Eagle portfolios trailed the S&P 500 Index in the third quarter. Stock selection was positive for Communication Services and Financials, but negative for Industrials, Information Technology and Consumer Discretionary sectors. Sector allocation was slightly negative, primarily driven by the underweight positions in Consumer Staples and Real Estate.

Purchases / Additions In The Quarter

Amazon.com Inc. (AMZN): Although one day shipping impacts profitability in the short term, we believe it will be made up with more volume and a stronger moat over the long-term. One day shipping will increase unit volume and net dollar proceeds to Amazon's merchants, some of which will flow back in the form of increased advertising dollars to Amazon.com. Lastly, one day shipping makes FBA (fulfilled by Amazon) more compelling to merchants, which increases supply on Prime and makes Prime more appealing to consumers. Although it is difficult to discount antitrust risks, our view is that these charges will be settled with the regulators either directly or via a court battle.

Corteva Inc. (CTVA): With the corporate restructuring of the Dow/DuPont complex behind us, we chose to consolidate our positions from the three post-transaction firms into Corteva. Our preference for Corteva over the other members of the complex was driven by its appealing end-market trends in emerging market crop production. In addition to secularly stronger end-market trends, Corteva's suite of proprietary products should enable the company to maintain a sustainable competitive advantage relative to peers.

Salesforce.com (CRM): Salesforce.com dominates the sales force automation space but still only controls 30% in a highly fragmented market that continues to grow double digits each year. The company has added legs to the overall growth story, including customer service, marketing automation, e-commerce, analytics, and artificial intelligence. Salesforce.com's margins are subscale, with a runway to more than 100 basis points of operating expansion annually.

Walt Disney Company (DIS): There is a growing expectation that Disney's DTC (Direct to Consumer) offering, which will gain pace with the launch of Disney+ and a more content heavy Hulu offering, will outperform consensus estimates. Consumer surveys suggest subscriptions will exceed expectations following strong content and global brand awareness. Additionally, as network business becomes a smaller part of overall company valuation, disappointments in network business will matter less to investors.

Sells / Trims In The Quarter

Cisco Systems, Inc. (CSCO): We trimmed Cisco after the company guided to a lower than expected revenue growth in the recent earnings report. Cisco highlighted weakness in China and in the service provider segment. Additionally, the company noted that its enterprise segment weakened significantly in July, which suggests that macroeconomic pressures were beginning to offset the strong product cycle that Cisco had riding over last two years. That coupled with its expensive valuation formed our decision to trim the position.

Dow Inc/ DuPont de Nemours Inc. (DOW/DD): With the corporate restructuring of the Dow/DuPont complex behind us, we chose to consolidate our positions from the three post-transaction firms into Corteva. Our preference for Corteva over the other members of the complex was driven by its appealing end-market trends in emerging market crop production. In addition to secularly stronger end-market trends, Corteva's suite of proprietary products should enable the company to maintain a sustainable competitive advantage relative to peers.

Paypal Holdings Inc. (PYPL): We trimmed Paypal for a number of reasons. First, Paypal was trading at an expensive valuation. Second, the company announced departure of its Chief Operating Officer, who is seen as the key product person within the executive circle. Third, Paypal revised lower its full year guidance in the recent earnings report. Lastly, Paypal faces a roll-off of its partnership with eBay in the second half of 2020, which may pressure its 2020 growth rate. When added together, these reasons were enough to warrant trimming the position.