EAGLE GLOBAL ADVISORS

Quarterly Commentary Q2 2020

EGA U.S. Equity

From the EGA Portfolio Management Team

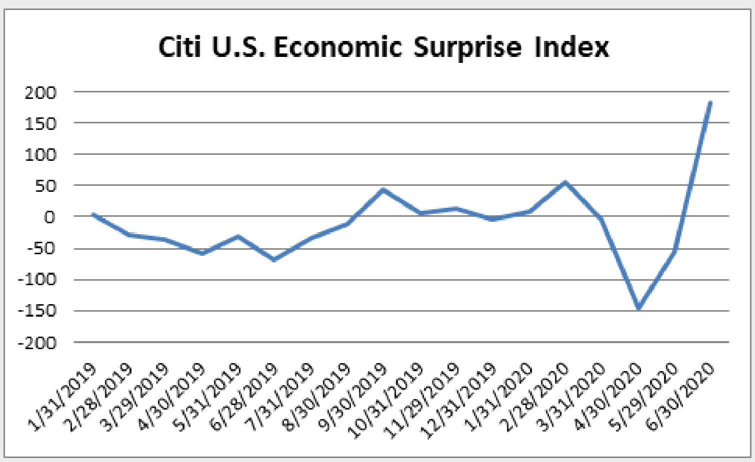
U.S. stocks wrapped up their best quarter in more than 20 years, a remarkable rally after the coronavirus pandemic brought business around the world to a virtual standstill. Just three months ago, investors were lamenting the end of the bull market - and the longest economic expansion on record - after major U.S. stock indices lost about 35% of their value in less than six weeks. The subsequent rebound has been nearly as brisk.

Thanks to an unprecedented $2.4 trillion stimulus package from Congress and additional monetary stimulus from the Federal Reserve, the quarter's rally lifted everything from beaten-down energy stocks to apparel retailers to big technology firms. The S&P 500 Index finished the second quarter up 20.5%.

However, after logging its biggest two-month percentage gain since 2009 in April and May, the S&P 500 rose just 2.0% in June on concerns of resurgence in coronavirus cases. The path ahead for the stock market is less clear given a premium valuation and heightened uncertainty related to coronavirus. A second wave of cases is seen as the most prominent risk facing stocks for the second half of the year.

Economy: A sharp rebound with pending concerns of a second wave

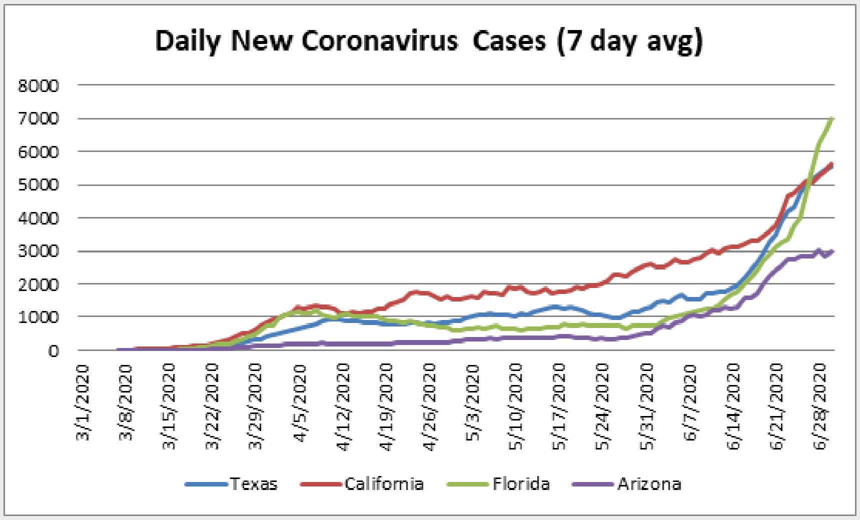
The disconnect between the pace of market recovery and recovery in the underlying economy has given many investors a pause. Nearly 20 million jobs have been shed since February and retail sales are far below pre-pandemic levels. Yet, the rebound in economic activity has been much stronger than economist forecasts. The Citi U.S. Economic Surprise Index, which tracks how economic data are progressing relative to the consensus forecasts, is at an all-time high. We believe this represents the challenge of forecasting during this pandemic.



Source: Citi, Bloomberg

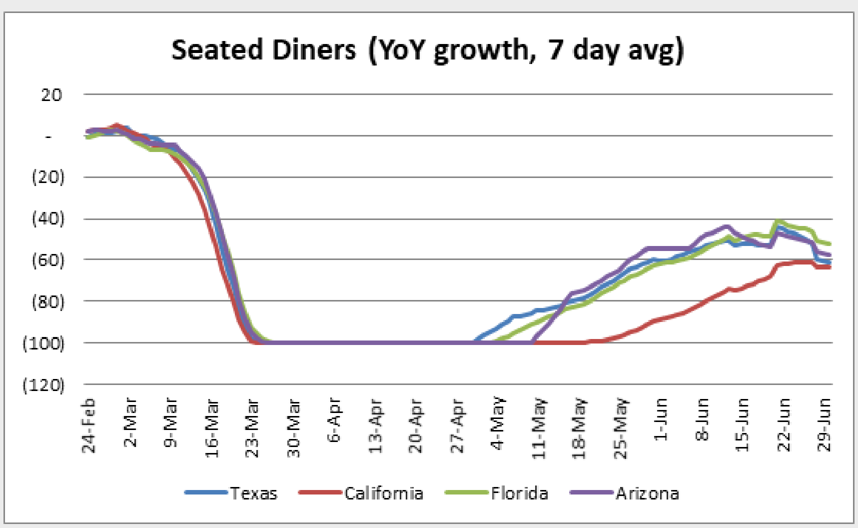
U.S. economic data began to beat expectations in May amid continued optimism about an abating coronavirus pandemic and the momentum from a reopening economy. Reopening optimism first emerged in April driven by evidence that the pandemic had peaked and leveled off in a number of initial hotspots. As the White House shifted its focus from mitigating and containing the virus toward reviving a stalled economy, more than half the states in the U.S. lifted some restrictions by the start of May. This in turn put some attention on an uptick in high-frequency indicators. Press reports highlighted improvements in air travel, public transit, truck traffic, driving direction requests, restaurant reservations, hotel occupancy, beach visits, vacation rentals, apparel and accessories sales, unemployment benefits, mortgage applications and new business applications.

However, the daily number of new coronavirus cases have started rising again. This has led to concerns of resurgence of the virus, which could potentially derail the economy's reopening. This narrative received credence when officials in several states paused or rolled back the lifting of some restrictions such as restaurant and bar reopenings.



Source: Bloomberg

The surge in new cases coincides with a pickup in underlying economic activity (see chart below on restaurant dining), suggesting that without stricter safety protocols and tight contact tracing procedures future economic growth will be tied to our tolerance for new case growth. The tolerance for new case growth is tied to the capacity of our hospital systems. We believe this relationship will keep a lid on economic expansion until we setup more robust safety protocols and contact tracing procedures or reach herd immunity, either through a vaccine or through a controlled spread, which could take anywhere from 6 months to 2 years.



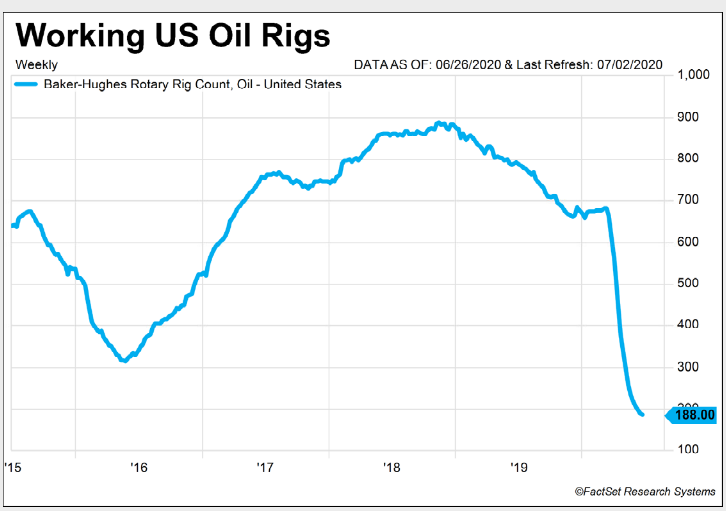
Source: OpenTable

Researchers around the world are working on more than 145 potential vaccines against the coronavirus, and 19 vaccines are in human trials. More than that number of potential treatments and therapies to mitigate the effects from infection are in trials. Vaccines typically require years of research and testing before reaching the clinic, but behind massive funding from government, industry, and philanthropy, scientists are racing to produce a safe and effective vaccine by next year. Under Operation Warp Speed, the Trump administration has underwritten the research and production facilities for five different approaches for a vaccine; other governments around the world have done the same for other potential vaccines. Nevertheless, vaccine development is notoriously difficult and time-consuming; the record is four years, and a decade is not unusual. However, promising early results have raised hopes that the goal of having a vaccine widely available by next year is possible. Until a vaccine is available, we are relying on improvements in treatments where good progress is being made as evidenced by the decline in the death rate while infections have risen.

The coronavirus pandemic has benefitted select industries while negatively impacting most other industries. The digital adoption curve has been pulled forward, benefitting companies in software, e-commerce, online streaming/gaming, payments, etc. On the other hand, companies in travel, brick and mortar retail, commercial real estate, automotive, energy, industrials, etc. have been negatively impacted. This divergence has also shaped our investment view for the near to medium-term.

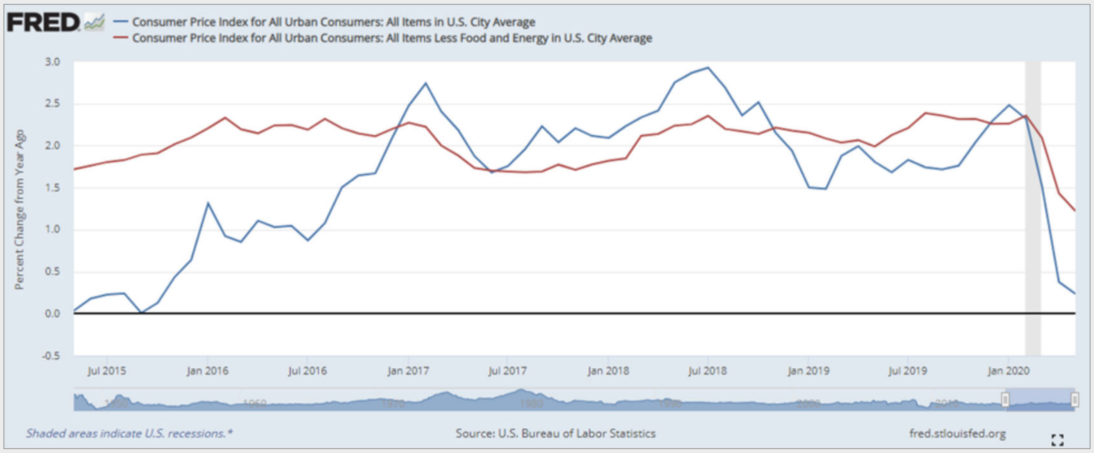
Oil: Price plunges to historic low before quickly rebounding due to improvement in supply-demand

The coronavirus transformed global oil markets in the first half of 2020, sending prices on a wild ride and spurring historic changes to energy supply chains and products used to invest in crude oil. Oil started the year trading above $60 a barrel. The pandemic and ensuing global economic shutdown took the price below $0 for the first time ever in late April. Within weeks though, prices had recovered and ended the quarter around $40. Behind the rally are the return of fuel demand after major economies started to loosen lockdowns and record output cuts by OPEC and allies including Russia. With companies forced to shut down productive wells, the U.S. crude supply tumbled to a two-year low of 10.5 million barrels a day, down from a record above 13 million barrels a day earlier in the year. The slide in production comes with the number of rigs drilling for oil also dwindling.



Inflation: *Core inflation declines due to pandemic*

Core U.S. inflation, which excludes volatile categories such as food and energy, rose 1.2% in May versus the prior year. The shelter index rose 2.5% and the medical care index rose 4.9%. Notable indices that declined include airline fares (-28.8%), motor vehicle insurance (-14.3%), apparel (-7.9%), and new vehicles (-0.3%). Core PCE inflation growth was steady at 1.0% on a year-over-year basis. Longer-term however, we remain concerned that the unprecedented fiscal and monetary stimulus may have a hangover effect in higher prices. How the authorities will deal with mopping up the liquidity after this crisis will have a significant effect on future inflation.



Corporate Profits: Downward revision to estimates continues

The impact of the coronavirus will be felt most in Q2 2020 earnings, which will include the impact of a global shutdown. Thereafter, quarterly earnings growth rates should improve and subsequently turn positive in 2021. Q2 2020 S&P 500 earnings are tracking to decline -44%. The largest decline will be felt in Energy, followed by the Consumer Discretionary and Industrials sectors. Right now 2020 earnings estimates are expected to decline -21%. High frequency data such as credit card receipts, air travel, vacation rentals, unemployment claims, mortgage applications etc. are suggesting improvements in economic activity, but this view can quickly change if new lockdown measures are introduced due to resurgence in coronavirus infections and/or a second wave of infections. This push-pull of uncertainty in forecasting keeps us from putting too much faith into 2020 earnings estimates. However, most observers expect a vaccine and other measures to return life to normal in 12 to 18 months, and the earnings power of corporations should also return to previously expected levels in most areas of the economy. As near-term earnings represent a fraction of the value of companies, we think the intrinsic value of corporations has not really changed much.

Interest Rates: Lower for longer, again

On June 10th, Federal Reserve officials signaled plans to keep interest rates near zero for years and said they were studying how to provide more support to a U.S. economy battered by the coronavirus and related shutdowns. In new projections released by the FOMC, all 17 officials who participate in the rate setting meetings said they expect to hold rates near zero next year, and 15 of them projected rates would stay there through 2022. Fed Chair Jerome Powell added that the FOMC was not even thinking about raising rates at the moment. The FOMC also announced it would maintain its recent pace of purchases of Treasury and mortgage securities, effectively ending prior plans of gradual reductions. The Fed is also concerned about potential long-run damage from the coronavirus to the economy. As a result, we expect the monetary policy outlook to remain extremely accommodative over the near to medium-term.

Fixed Income: Risk premia fall

In contrast to last quarter, Treasury yields on the short and long end of the curve were stable in the second quarter. The 10-year yield started the quarter at 0.68% and ended the quarter at 0.66%. Short-term yields were near zero as the Fed kept its Fed Funds rate between 0.0% and 0.25%. The quarter, however, saw a large drop in credit spreads, as the unprecedented fiscal and monetary stimulus taken by government authorities calmed the extreme fears of immediate economic distress prevalent in March. Our fixed income portfolios outperformed the wider fixed income market as our greater exposure to corporate credit benefited from the compression in spreads. Credit spreads remain elevated relative to recent history and we are maintaining our exposure to this fixed income asset class as we believe the high spreads should continue to compress as the economy heals.

Stock and Portfolio Highlights

Eagle portfolios outperformed the S&P 500 Index in the second quarter due to better stock selection in Information Technology and Communication Services sectors, and better allocation in the Consumer Staples sector.

Purchases / Additions In The Quarter

Duke Energy Corp. (DUK): Duke is one of the largest regulated utilities traded in the U.S. The company operates in jurisdictions that are expected to see above-average demand growth. Additionally, Duke stands to significantly benefit from the transition from fossil fuels to renewables. This should allow Duke to generate above average growth and continue to close its profitability gap with peers, which has left the shares trading at a slight discount to the peer group.

Dow Jones U.S. Aerospace & Defense ETF (ITA): Investment in the ETF offered a diversified way to gain exposure to cyclically sensitive companies that have sold off significantly more than the broader market index and would benefit from a rebound in air travel.

JPMorgan Chase & Co. (JPM): The firm is a leader in investment banking, financial services for consumers and small businesses, commercial banking, financial transaction processing and asset management. Economies of scale combined with investments in technology enabled JPMorgan to cut costs and gain share across all segments. We believe the company is well positioned to navigate the current environment thanks to its diverse revenue stream, strong balance sheet and best in class management team.

Mastercard Inc. (MA): Mastercard is the second largest global card network worldwide that benefits from the ongoing global secular shift toward electronic payments. Its business is highly defensive and characterized by recurring revenues, high incremental margins, low capital expenditures and high free cash flow. The bigger untapped opportunity now lies in business-to-business payments. While the coronavirus will significantly impact near-term growth, we believe the secular trends toward electronic payments will only be accelerated by the pandemic.

Microsoft Corp. (MSFT): Microsoft's business has been resilient during the coronavirus pandemic. The utility of its cloud based services couldn't have been more demonstrative during the pandemic's 'work from home' period. Azure (Microsoft public cloud) is benefiting from the growing cloud adoption by the enterprises that make a very large percentage of overall IT budgets. Enterprises gravitate toward Microsoft Azure because they already operate in a Microsoft environment (Windows, Office, Server operating systems etc.) and Microsoft is better positioned to painlessly move their applications to the cloud.

NextEra Energy Inc. (NEE): NextEra is the largest regulated utility traded in the U.S. NextEra consistently delivers best-in-class growth driven by the company's best-in-class exposure to renewables-based generation growth. A bit more than half of the company's revenue comes from its Florida-based regulated utility, while the balance is primarily generated by a portfolio of renewables-based assets operating on long-term contracts in competitive jurisdictions.

Palo Alto Networks Inc. (PANW): Palo Alto has benefitted from 'work from home' trends as customers have had to expand firewall capacity to support traffic. Although this trend is likely to be transitory, it helps fill the hole in firewall sale while the company ramps its next generation security portfolio. On the other side of this transition, we expect Palo Alto's next generation security solutions to more than outweigh any weakness in firewall sales. Longer-term, cybersecurity remains a focal point in the minds of CTOs and CIOs. PANW compares favorably to competition because it brings the most complete set of cyber security tools, including the best of the breed next generation security solutions.

Schwab Strategic Trust US REIT ETF (SCHH): With the coronavirus pandemic dragging down the Real Estate sector valuation opportunities have begun to emerge. We decided to utilize the ETF as a placeholder to gain exposure to the sector, an area where we were void.

Truist Financial Corp. (TFC): The transformative merger of equals (BB&T & SunTrust) makes Truist Financial the 6th largest U.S. bank by assets. TFC will have a dominant and concentrated presence in one of the strongest and fastest-growing regions of the U.S. – the Mid-Atlantic coast and Southeast. We believe TFC has more ability than peers to navigate the challenging macro environment as it can offset some of the top-line pressures through merger cost savings, revenue synergies and balance sheet optimization. Also, half of their balance sheet is already marked to market (due to purchase accounting), which positions them well for a credit downturn.

Sells / Trims In The Quarter

Berkshire Hathaway Inc. (BRK.B): Eagle reduced the investment in Berkshire to raise funds from a defensive growth company and reallocate to the economically sensitive Aerospace and Defense value sector and a bank value company. On the margin, we believe the rapid response of the Federal Reserve to provide struggling companies ample liquidity prevented Berkshire Hathaway from consummating any significant distressed deals. Berkshire Hathaway's lack of dividend, sub S&P 500 rebound growth potential and a lack of crisis period investment deals during the pandemic will challenge its relative performance to some of the more cyclical financials during a market recovery.

Booking Holdings (BKNG): Booking Holdings is 100% exposed to travel accommodation bookings. We expect the travel sector recovery to lag the broader market index. As a result, we decided to high-grade our portfolio by swapping Booking Holdings with Mastercard at a time when both stocks were down nearly the same from their peaks.

Walt Disney Co. (DIS): We trimmed the position in Disney to de-risk from the lingering impact of covid-19's social distancing norms that discourage large congregations. We believe it will be challenging for Walt Disney to run its Parks, Studios and Consumer Products divisions under these circumstances.

East West Bancrop Inc. (EWBC): EWBC faces revenue pressure from low rates as most of their loans are based on variable rates. We expect weaker loan growth as the coronavirus impacts economic activity and leads to lower consumer/corporate expenditures. We are also concerned about rising credit losses given their exposure to the Oil & Gas, retail, hospitality and travel industries.

S&P 500 Index Spiders ETF (SPY): We utilized the ETF as a placeholder to add market beta to the portfolio after a precipitous decline. We sold the ETF to allocate the proceeds to individual companies.

Select Sector SPDR Utilities Fund (XLU): After serving as a placeholder, we decided to redeploy the weight into attractive opportunities within the Utilities sector.

Twitter Inc. (TWTR): Marketing budgets are usually the first to get cut during a recession. Within marketing, brand advertising tends to be more exposed to budget reductions. Twitter is over indexed to brand marketing customers compared to other digital advertising platforms. Even though the utility of the platform increased during this 'stay at home' strong news-cycle period, it didn't insulate the company from budget cuts at its customers. Twitter is responding to this change by building out its direct response advertising platform. We believe this change will be positive for the company, however, the initiatives will take some time to show results.