Market Review and Outlook

Q1 2018

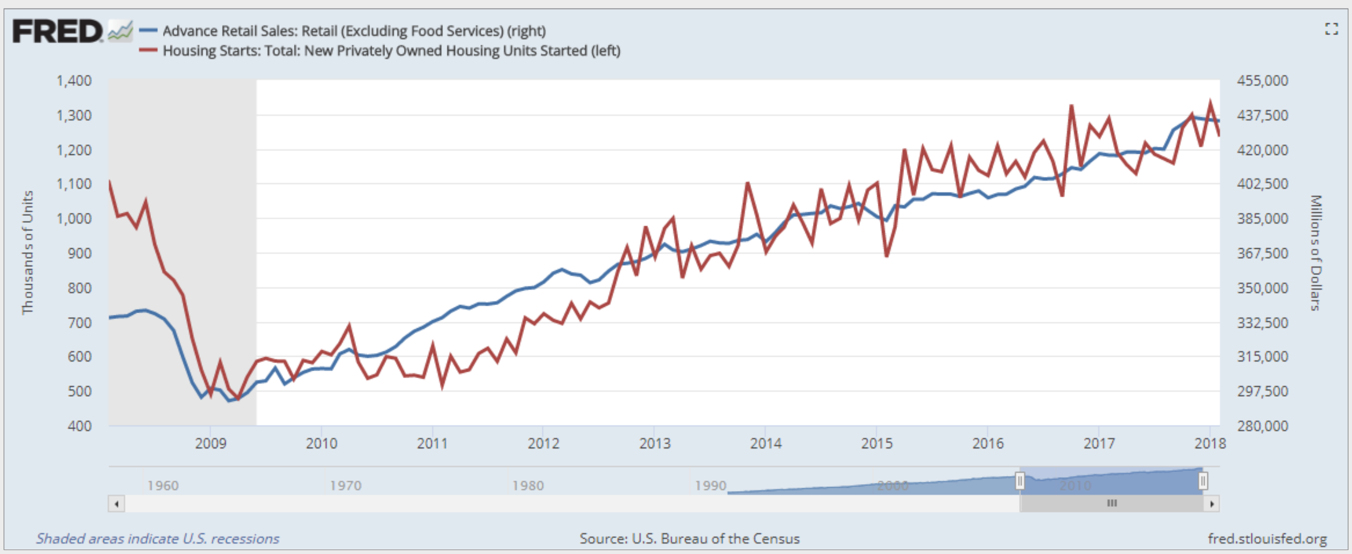
EGA U.S. Equity

From the EGA Portfolio Management Team

After a strong performance in January the rally in U.S. stocks stumbled from uncertainty over potential rising interest rates, the ramifications of trade tariffs, and doubts about the sustainability of gains from technology companies. For the quarter, the S&P 500 Index declined by -0.8%. International equity markets, represented by the MSCI EAFE Index, declined -1.5%. The Federal Reserve raised interest rates again in March, leading to negative returns for fixed income. We believe investor concerns about trade tariffs, while valid, are premature because of the evolving nature of these negotiations. Additionally, we believe concerns surrounding certain technology companies have led to a sector wide pullback, which has opened a window of opportunity for investments in the technology sector.

Economy: *Economic Growth Continues With Some Loss Of Momentum*

U.S. Q4 real GDP growth was revised up to a 2.9% annual rate from 2.5% in the previous estimate, above the consensus rate of 2.7%. It was driven by upward revisions to personal consumption expenditures, which was revised higher to a 4.0% annual rate from 3.8%, the fastest pace in three years.

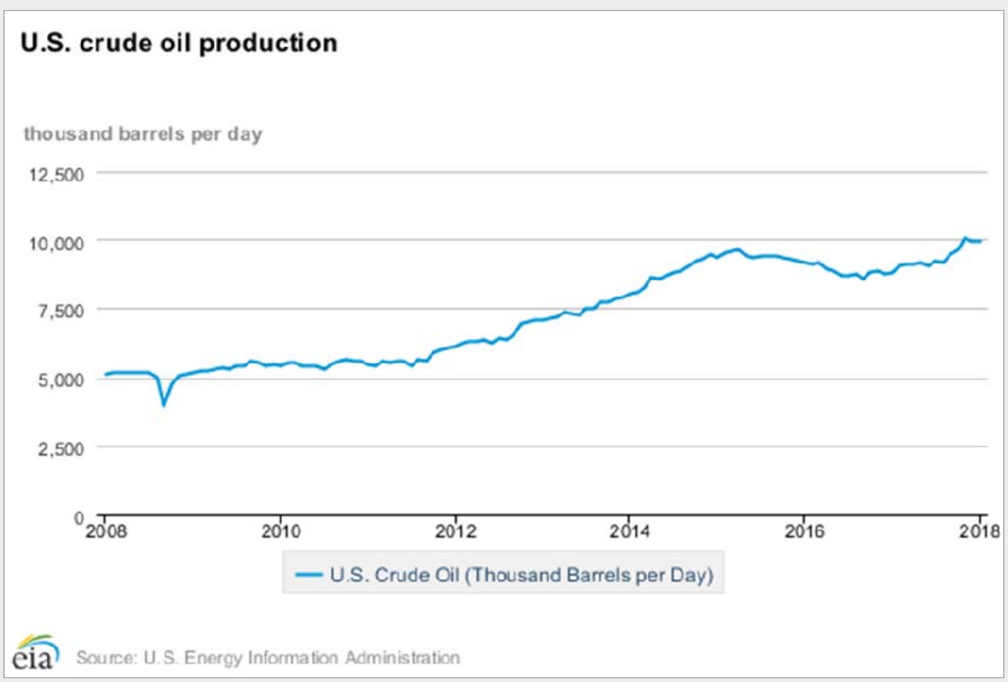


Retail sales slipped 0.1% in February, contrary to the consensus for a 0.3% gain, primarily due to weakness in vehicle sales. Like last year, the recent weakness was likely due in part to delayed tax refunds as part of the IRS procedures to reduce fraud. Severe winter weather in the Northeast might also have played a role. Still, the lackluster performance of retail sales suggests that consumers are not too eager to spend, even though their paychecks have grown recently with the tax reform. Housing starts fell 7.0% in February, its second decline in the past three months, to a 1.236 million unit annual rate, below the consensus expectation for 1.276 million unit rate. The decline was driven by a 28.0% drop in multifamily starts, the most since September 2016. Single family starts rose 2.9% and have been up in four of the past five months.

The ISM Manufacturing Index fell 1.5 points in March to 59.3, below the consensus projections. While factory activity moderated slightly, the current level of the index is still consistent with above-trend economic growth. The NFIB Small Business Optimism Index rose 0.7 points in February to 107.6, the second highest level on record, as small businesses remain very optimistic about the economy and their prospects for growth. Over the past six months, 66% of firms, the highest share since April 2004, made capital expenditures, concentrated in equipment and vehicles. Nonfarm payrolls increased 313,000 in February, the biggest gain since July 2016, while the unemployment rate was unchanged at 4.1%. The broad measure of unemployment and underemployment known as the U-6, which includes people stuck in part time jobs, remained at 8.2%. The Conference Board's Consumer Confidence Index fell 2.3 points in March to 127.7. Despite the modest pullback this month, confidence is at its second highest level since December 2000 and is historically consistent with above-trend economic expansion.

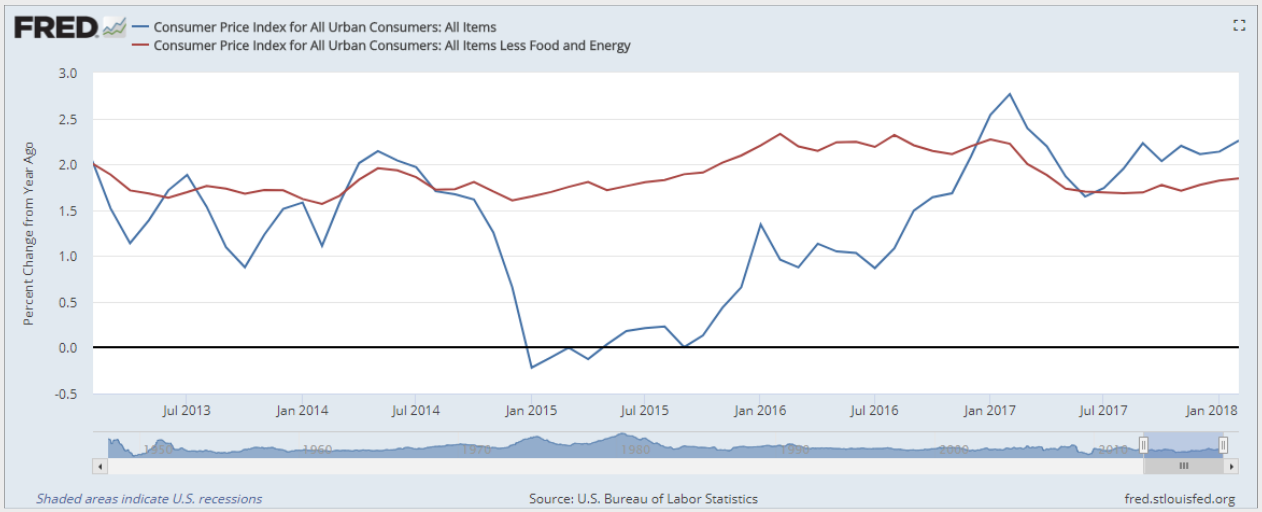
Oil: *WTI Continues To Rally*

West Texas Intermediate, the U.S. crude benchmark, ended the quarter 7.5% higher at $65. Crude prices rose above $70 a barrel to three-year highs in January before falling back on fresh indications of burgeoning U.S. shale oil production. Prices have been bolstered in recent weeks by declining crude stocks outside the U.S. and rising tensions between the U.S. and Iran. Commodity analysts now widely expect the Trump administration to withdraw from the 2015 Iran deal and re-impose some economic sanctions on Iran that would ultimately hinder the country's oil exports by up to 350,000 barrels a day. With the inventory cushion largely gone, oil prices will likely be more sensitive to geopolitical risk factors again. So far in this recovery, oil prices have been supported by the OPEC/Russian production cuts of around 1.8 million barrels a day, or nearly 2% of global supply. That production cut deal is set to expire at the end of 2018, but Saudi Arabia has suggested it could continue coordinating with Russia on production curbs into 2019.



Inflation: *Remains Under Wraps*

The Consumer Price Index (CPI) increased 2.2%, up slightly from 2.1% in the previous month. Core CPI, which excludes food and energy prices, rose a steady 1.8% year-over-year. Shelter prices have moderated to 3.1% year-over-year, the least since August 2015. Excluding shelter, core CPI inflation remains very limited, just 0.9% year-over-year, and still close to the slowest pace since 2004. Core CPI commodity prices remain in deflation territory. However, several other inflation measures are pointing upwards. The U.S. Producer Price Index (PPI) excluding food and energy increased 2.6% (versus last year), the most since November 2011, indicating some pickup in inflation pressures on the producer side. The U.S. inflation expectations, measured by the breakeven inflation rate implied from Treasury Inflation Protected Securities (TIPS), have come down from previous months, but remain elevated relative to last 4 years. We continue to view inflation to be one of the most important variables to watch this year.



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Corporate Profits: *Profits Growth Expected To Accelerate*

According to Factset, Q1 earnings for the S&P 500 Index are estimated to grow 17.3% (versus last year), the highest since Q1 2011. All sectors are expected to report year-over-year earnings growth, led by Energy, Materials and Information Technology. With the S&P 500 Index currently near 2614, the Price-to-Earnings Ratio of the market is around 16.5 times the 2018 mean earnings estimate, slightly above its long-term average. While valuations are just a bit above average levels, stocks do not appear expensive relative to bonds and inflation. Also supporting valuations is robust expected earnings growth. According to Factset, S&P 500 earnings are expected to grow 18.5% in 2018, after a 11.7% increase in 2017.

Interest Rates: *A Steeper Path Of Rate Hikes*

As expected, the FOMC raised interest rates for the sixth time this cycle, moving the target range for the Fed funds rate up by 25 bp to 1.50%-1.75%. The Fed is now projecting a steeper path of rate hikes. The projection for 2019 Fed funds rate was raised from 2.688% to 2.875%. The projection for 2020 was raised from 3.125% to 3.375%. The steeper path is supported by improved GDP growth outlook, tighter labor market conditions and modestly higher inflation expectations of the FOMC members.

Fixed Income: *Rates Rise*

Continuing a pattern established since the election of Trump in the fall of 2016, interest rates continued to rise this past quarter prompted by signs that the economy is near its full potential. Short-term rates, as proxied by the two year government note, rose 37 basis points from 1.89% to 2.26%. Long-term rates also rose, but not as much as short-term rates, leading to a flattening of the yield curve. The 10-year government bond rate ended the quarter at 2.75%. A strong economy led to improving corporate credit metrics which made credit spreads stay tight. At their March meeting, the Federal Reserve increased the Fed Funds rate target range by 25 basis points to the 1.50%-1.75% range. We expect that the Fed will increase rates probably two more times this year, creating upward pressure on rates at all maturities. We continue to position our fixed income portfolios in shorter duration assets; as we are comfortable with the credit conditions, we also favor corporate bonds in our portfolios.

Stock and Portfolio Highlights

Outperformers: Eagle domestic equity portfolios outperformed the S&P 500 Index for the quarter. Consumer Staples, Information Technology and Financials were the top performing sectors relative to the benchmark. On an absolute level, Consumer Discretionary stocks performed best, followed by Information Technology and Financials.

Disappointments: Stock selection in Health Care and Industrials weighed on performance relative to the benchmark.

Purchases / Additions In The Quarter

Alphabet Inc.: Alphabet, the parent of Google, recently missed analysts' consensus estimates for its Q4 earnings, primarily due to higher Traffic Acquisition Cost (TAC). TAC is a fee that Google pays to smartphone makers to be the default search engine on smartphone browsers. The fee was negotiated higher, but analysts were blindsided as these negotiations are kept private. A higher TAC burden can be offset by increased penetration of Google's chrome browser, which it continues to promote. Additionally, there were some elevated marketing costs in Q4 for new Google hardware. We consider the latter as a one-off item. At 12x EBITDA multiple, the stock looks attractively priced for its worst case EBITDA growth scenario of 15%.

Booking Holdings: Booking Holdings (formerly Priceline) reported a thesis changing quarter. It delivered 400bps of marketing efficiency (the largest expense item), which we believe is likely to increase in the near-term, but not priced into consensus analyst estimates. Additionally, alternative accommodations are currently in growth phase, which results in higher operating expenditures without corresponding increase in revenues. In the future, potential increases in capacity utilization of alternative accommodations should drive revenue higher and increase margins.

Microsoft Corp.: We believe Office 365 will consolidate software spending in analytics, identity access management, telephony and segments of the security market over the next 3-5 years. Additionally, we expect operating margins for Azure to continue to improve and reach levels achieved by AWS at similar revenue run rate. We expect operating income to grow at double digit rates over the medium-term.

Qualcomm Inc.: We added to Qualcomm after Broadcom raised its takeover offer to $82 per share because we expected shareholders to vote in favor of Broadcom's proposal. However, the takeover attempt was thwarted by the U.S. government on national security grounds. Absent the takeover offer, Qualcomm still has several value creation opportunities, including the resolution of a licensing dispute and the closing of a deal with NXP Semiconductors. Broadcom's takeover offer has reminded investors of the inherent value in Qualcomm's leadership position in cellular technology.

Twitter Inc.: Twitter continues to drive user engagement higher with product improvements in timeline, video, and live streaming. Recent checks have pointed to improved advertiser sentiment towards the platform. We view Twitter as a unique social media asset for tracking live events that could be monetized organically or as a part of a larger media conglomerate.

Haliburton: Through its market leading position in hydraulic fracturing, Halliburton offers a leveraged play on the Permian basin, possibly the most attractive non-OPEC basin in the world. Permian Drilled But Uncompleted (DUCs) saw a dramatic build in 2017 and will likely be worked down in 2018, while a move to more large-pad drilling creates additional completion inventory. Green shoots in international basins also benefit Halliburton, a global leader in oilfield services.

Raytheon: Raytheon (RTN) benefits from increased U.S. and global defense spending. Though continued global tensions have buoyed the entire group, RTN is positioned particularly well for the ongoing defense spending uplift. In particular, RTN is well exposed to orders of the likeliest ticket items through their leading positions in missile defense systems and missiles. Additionally, RTN's products are well suited to international threats, exposing RTN to higher-growth/higher-margin international markets. RTN has the highest percentage of sales from international markets relative to Defense Prime peers. Finally, RTN's exposure to cybersecurity, while small, gives it a unique growth engine.

Sells / Trims In The Quarter

Apple Inc.: AAPL is primarily an iPhone company with 65% of revenue and (likely) more than 65% of profits driven by iPhone. iPhone X sales estimates have now matured, pricing in the iPhone super cycle. The super cycle by definition is a peak cycle in iPhone unit sales. With peak sales priced into consensus estimates, we decided to trim the position.

Micron Technology: Memory prices have seen a very strong rally over the last 2 years. We believe this rally is now near maturation. Additionally, some looming regulatory risks and new capacity build in China left us more comfortable with a trimmed position in Micron.

Check Point Software: Check Point missed analysts' earnings estimate for the second consecutive quarter and guided below consensus estimate as billings declined for the first time in five years with weakness in North American segment. Decelerating growth and the need to invest in marketing to defend market share in a competitive environment left us less positive on the stock.

Alaska Air Group: Since we trimmed this position, Alaska Air's execution has continued to stumble. This failed execution has led to continued downward revisions, which brought about a deterioration of Alaska Air's rank in our model. Expectations for continued execution woes portend deterioration in fundamentals, including declining margins and ROE.

Celgene: The FDA sent Celgene a refusal letter for its Ozanimod NDA filing for relapsing multiple sclerosis (RMS). Revlimid patent litigation and a lack of enough pipeline assets to replace corresponding revenues continue to be an overhang on the stock. The company's strategy to purchase and collaborate with early stage companies, like Juno, that generate little revenue will use most of their free cash flow with a high uncertainty of success.