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Top Holdings

Wells Fargo & Company

Bank of America

Staples

Johnson & Johnson

Tyco International

ConocoPhillips

ExxonMobil

Microsoft

Omnicom Group

Pfizer

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Market Overview | Stocks fell broadly in a volatile second quarter, weighed down by mounting concerns over global economic recovery, sovereign debt levels and regulatory trends that benefited defensive investments, such as Treasury securities. In a recovering, but fragile, global economic environment, above-average-performing S&P sectors in the quarter included utilities, telecommunication services, consumer staples and consumer discretionary. Below-average-performing sectors included healthcare, information technology, industrials, energy, financials and materials. No S&P sectors had positive returns.

Portfolio Review | Outperforming portfolio sectors included: market-weighted energy (e.g., EOG Resources and ConocoPhillips); market-weighted industrials (e.g., Tyco International, Union Pacific and PACCAR); and market-weighted telecommunication services (e.g., Sprint Nextel). A normal level of cash reserves in the declining market had the highest positive contribution to the portfolio's relative return. Underperforming sectors included: underweighted financials (e.g., Bank of America, Wells Fargo and Goldman Sachs); consumer staples primarily due to low sector allocation in an above-average-performing S&P sector); overweighted information technology (e.g., Adobe Systems and Autodesk); overweighted consumer discretionary (e.g., Staples and Bed, Bath & Beyond); and slightly overweighted healthcare (e.g., Covidien).

The strongest contributors to performance were: Sprint Nextel on analyst upgrades and the company's announcement of pricing and sales data for its new EVO phone; EOG Resources as the company raised its oil-production guidance for 2011 and 2012; and PACCAR, sold May 12 to take profits and lessen the portfolio's exposure to the troubles in Europe. Performance detractors included: Bank of America and Wells Fargo on concerns that pending banking-regulatory-overhaul legislation could result in operating constraints and lower debt ratings for major banks (due to a lack of assumed government support); and Microsoft on concerns that demand could be impacted by euro-zone contagion spreading to the larger European markets.

Outlook | Sluggish growth is anticipated going forward as the temporary boost from business inventory-rebuilding following last year's recessionary liquidation transitions to a sustainable pace and consumer-spending growth remains constrained by modest income growth, further "deleveraging" to restore balance-sheet health and uncertainty regarding the difficult job market. The gradual phase-out of government stimulus programs as well as continuing low interest rates will also have a dampening effect on private-sector growth. Stronger-than-expected earnings reports in recent quarters, primarily on cost reductions, along with sharply reduced capital investment during the recession have restored healthy cash levels to corporate balance sheets, particularly for larger companies. Further profit-margin expansion and revenue growth can support renewed capital investment and hiring as global excess capacity is gradually absorbed. But austerity measures abroad, announced by the United Kingdom, the euro-zone and Japan, as well as the business climate domestically, have an impact on major corporate hiring and capital-investment decisions.

Our outlook for some time has been for sluggish economic growth, recognizing the atypical headwinds facing the current recovery cycle, but particularly encouraged by the sharp improvement in corporate profitability that can support continued growth. The recent capitulation by hedge funds and others in reversing their global V-shaped recovery-based positioning, along with euro-zone sovereign-debt concerns, have created extreme volatility and shaken investor confidence, driving

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Benchmark Index:

The Standard & Poor's 500 Index (S&P 500) is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market.

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valuations to what we view as very attractive levels. Daily returns now seemingly teeter-totter on the question, Will we have a double-dip recession? We don't believe that is the correct framework for evaluating the investment environment. It is undeniable that confidence (in the economy and government) is low but it is very clear to us that U.S. corporations – aside from banks – are extremely healthy, flush with cash and very attractively valued vs. fixed-income investments. If the economy does “double-dip,” we believe companies are prepared and valuations are inexpensive so losses should be modest compared to recent bloodletting. We don't predict a double-dip but if it happens, our long term positive return expectations are unlikely to change.

Because the strategy/fund normally will hold a focused portfolio of stocks of fewer companies than many other diversified strategies/funds, the increase or decrease of the value of a single stock may have a greater impact on the asset value and total return.