

# Eagle Mid Cap Growth Fund

FIRST QUARTER | 3/31/12

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## Bert L. Boksen, CFA

Managing Director  
and Portfolio Manager

## Eric Mintz, CFA

Portfolio Co-manager

## Chris Sassouni, DMD

Assistant Portfolio Manager

## Characteristics

Total Net Assets (millions) \$510.8  
Number of holdings 74

## Top Holdings

Herbalife  
Cerner  
Dollar Tree  
Sally Beauty  
Ansys  
GNC Holdings  
Priceline.com  
CF Industries  
SiriusXM Radio  
SBA Communications

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## Market Overview

The Russell Midcap Growth Index reflected solid absolute performance (up 14.5 percent) for the first quarter of 2012. Growth-oriented investing led value for the quarter (the Russell Midcap Value was up 11.4 percent). With the exception of utilities, all sectors within the Russell Midcap Growth posted positive returns for the first quarter and were led by information technology, healthcare and consumer discretionary.

## Portfolio Review

On a relative basis, the fund outperformed in information technology, consumer staples, consumer discretionary and energy due to stock selection.

Our best-performing stocks included Herbalife, Huntsman and Cerner. Herbalife offers a vast range of weight-management and nutritional supplements through a global direct-sales network. The firm's daily-consumption model and geographically diverse revenue base continue to see positive growth as consumers increasingly pursue healthy lifestyles. Huntsman manufactures chemical formulations (e.g., adhesives or coatings) used in the commercial, aerospace and automotive industries. Pricing strength in the firm's pigments segment has allowed Huntsman to take advantage of a recent boost in demand, as prospects for a budding construction recovery begin to come into view. Huntsman also benefits significantly from low natural-gas prices. Cerner supplies healthcare information-technology solutions. The firm's solid positioning in the healthcare information-technology space has allowed it to benefit from the continued shift of the healthcare industry toward electronic health records and other technology-based systems. Earnings and backlog have expanded dramatically in recent periods as well.

Every sector within the fund's portfolio generated positive absolute returns for the

quarter but we slightly lagged benchmark returns in the industrials sector. Our worst-performing stocks during the period were Gentex, Cabot Oil & Gas and Polypore International. Gentex develops and manufactures automotive and fire-protection products. Standards proposed to mandate the implementation of rear-camera displays (RCDs), one of the firm's core offerings, on new vehicles have been postponed until the end of 2012. Despite this legislative delay, trends in the automotive industry continue to shift toward the use of backup cameras and technology-enhanced mirrors, which is expected to favor Gentex going forward. Cabot Oil & Gas engages in the exploration and production of natural gas and crude oil from properties near the Appalachian and Rocky Mountains as well as the Gulf Coast. With natural-gas production as the firm's more prominent segment, depressed prices have presented modest headwinds of late. Cabot also possesses oil-based drilling projects that have become more active to take advantage of the currently more favorable oil prospects, as the firm looks to offset reduced activity on the natural-gas side. Polypore is a specialty filtration company that makes separation membranes used in lithium-ion batteries, which have seen significant growth from both consumer electronics and hybrid electric vehicles. The stock underperformed due to concerns about waning sales for the all-electric Chevy Volt, which was the subject of a well-publicized investigation into engine fires that had occurred following crash tests. The investigation has since been resolved and high gasoline prices have helped boost sales of the Volt.

## Outlook

The first-quarter's rally was broad-based with virtually every sector participating. Corrections are likely but historically, the sharp first-quarter rally suggests 2012 will prove to be a strong year for equities. The rally reflected a positive change in most economic data

as autos were strong, housing has at least finally bottomed, unemployment is trending modestly down and gross domestic product (GDP) forecasts have been moving modestly higher. Sovereign-debt remains a big long-term issue but some resolution of the Greek situation also helped. We believe the European crisis interrupted a strong bull market that began off the March 2009 bottom. Retail investors stung by the 2008 financial crisis remain, for the most part, on the sidelines but we believe there are signs indicating asset flows into fixed income could reverse as interest rates trend higher. Some of that money likely will flow into the equity market. And as we move closer to the presidential election, government policy should continue to be pro-growth. The possible reversal of the restrictive healthcare law as well as the increasing probability both houses of Congress will go Republican should serve as positive catalysts.

During the first quarter of 2012, energy commodity prices diverged sharply as natural gas and coal plunged while oil prices firmed. Natural-gas inventories reached record levels due to weak demand resulting from extremely mild winter weather and continued growth in supply from shale operations. In response to extremely depressed natural-gas prices, utilities have begun switching away from coal to natural-gas-fired power generation where possible, causing thermal coal inventories to reach multi-year highs. With natural-gas prices falling well below break-even levels for the vast majority of gas operations, the natural-gas direct-rig count has fallen sharply. Similarly, coal producers also have begun to sharply curtail production levels.

Against this backdrop, we believe both coal and natural gas appear to

have begun a bottoming process that could set the stage for a cyclical rally given overwhelmingly negative investor sentiment. We have recently initiated modest positions that would benefit from any upside while limiting our downside risk in the event we are premature. This shift represents a slight departure from our longstanding preference for companies with exposure to oil. Importantly, this does not diminish our conviction in the outlook for “oily” names in the space, which should post accelerating earnings growth as business picks up commensurate with the sharp rise in the oil-rig count.

Within the industrials space, we see several attractive end markets that are in the midst of cyclical upturns. The outlook for aerospace, a longstanding overweight, remains robust due to record backlogs at both Boeing and Airbus. Our favored names designed to take advantage of this theme are Triumph Group, Hexcel and BE Aerospace. Improving consumer confidence – bolstered by lower unemployment and signs of stabilization in housing – may help spur a long-awaited upgrade cycle for residential air-conditioning units. An estimated 70 million of the 100 million installed residential AC units are in excess of 10 years old. Early indications suggest the selling season is off to a brisk start helped by warm weather, which bodes well for representative holding Lennox International. Finally, we are encouraged about the prospects for a budding recovery in commercial and residential construction. In fact, construction-equipment rental companies are already benefitting from increased utilization and rental rates. As a result, the rental companies have announced plans to replace their older fleets with newer equipment, which should drive significant

growth for equipment manufacturers (e.g., Terex) going forward.

Healthcare is now in the midst of a period of great uncertainty as the U.S. Supreme Court reviews the constitutionality of the Affordable Care Act by President Obama in early 2010. Almost irrespective of the Supreme Court’s decision, we believe the healthcare industry is undergoing massive transformation as it prepares to shift from a fee-for-service to a value-based model. There may be volatility around some sectors of healthcare – managed care and hospitals – but we continue to believe that those companies focused on reducing costs for the healthcare industry will enjoy strong demand and solid profits for their products and services. As such, we continue to hold companies that offer healthcare information systems to physicians and/or hospitals. Healthcare firms are investing feverishly to upgrade their systems, in part due to the availability of federal grants supporting information-technology adoption.

We also believe the Medicaid managed-care companies are well-positioned to capitalize on the \$50 billion pipeline of potential state contracts that are currently percolating. States realize they can save millions by moving their Medicaid programs from fee-for-service to managed care. The key to making money in healthcare going forward will be to locate firms that are benefiting from government-mandated initiatives or to focus on consumer-oriented parts of healthcare.

We believe we are in the “first inning” of what will be a gradual rise in interest rates. The Federal Reserve figures to keep rates low through the presidential election; however, equity markets should begin anticipating this later in

the year. Stocks we believe will do well in this environment include representative holdings TD Ameritrade and Ameriprise Financial.

A strong performance driver in technology has been acquisition activity, which not only moves the acquired company's stock sharply higher but tends to raise all ships. The ingredients for continued acquisition activity – such as a relatively low-growth environment, strong balance sheets and low interest rates – remain in place. Specific takeovers are hard to predict so we focus on companies that have strong fundamentals and operate in spaces that we believe are likely to see acquisition activity. We continue to focus on growth opportunities such as security software, which is mission-critical for both commercial and government customers, along with analytics software, which can generate a strong return on investment for customers. Examples of such holdings are Fortinet, Check Point Software

Technologies, TIBCO Software and Informatica.

Consumer stocks led the charge in the strong first quarter. We have two themes within our consumer space: health/nutrition and the continued expansion of gaming. Within health and nutrition, we own GNC Holdings and Herbalife. Both stocks have been strong performers benefitting from favorable demographics and consumer preferences for a healthy lifestyle. In gaming we are represented by Bally Technologies. The continued expansion of gaming globally is sure to continue, in our view, as states scramble to balance budgets.

*Investing in small- and mid-cap stocks may involve greater risks than investing in larger, more established companies. These companies often have narrow markets and more limited managerial and financial resources.*

### Eagle Mid Cap Growth

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Growth companies are expected to increase their earnings at a certain rate. When these expectations are not met, investors may punish the stocks excessively, even if earnings showed an absolute increase. Growth company stocks also typically lack the dividend yield that can cushion stock prices in market downturns.

The companies engaged in the technology industry are subject to fierce competition and their products and services may be subject to rapid obsolescence. The values of these companies tend to fluctuate sharply.

#### Benchmark Index

The Russell Midcap Growth Index measures the performance of those Russell Midcap companies with higher price-to-book ratios and higher forecasted growth values. The stocks are also members of the Russell 1000 Growth Index. It is not possible to invest in an index

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