

Eagle Equity Income

FIRST QUARTER | 3/31/12

EAGLE | Asset Management

Market Overview

The S&P 500 Index continued the rally that began in fourth quarter of 2011 to post a 12.6 percent return in the first quarter of 2012. Sectors that typify the “risk-on” trade – including the beaten-down financials sector, the usually volatile technology sector and the somewhat unpredictable consumer discretionary sector – led the rally. Forgotten were those stocks in the boring, “risk-off” category, such as utilities and consumer staples.

Market participants were encouraged by continuing stabilization in European sovereign-bond markets. The controlled default of Greece removed some of the risk overhang in Europe. In the United States, investors were encouraged by the ongoing healing of the banking system as evidenced by the Federal Reserve’s latest round of stress tests. Although there were a few exceptions, the Fed’s study showed that banks are back on sound footing. Investors are clearly feeling better about the prospects for the market with volatility down 66 percent since October 2011.

Portfolio Review

Eagle Equity Income portfolios trailed the benchmark S&P 500 Index in the first quarter. This is pretty typical in bull markets when the aforementioned “risk-on” stocks have solid runs. Close examination of our strategy’s performance vs. that of the S&P 500 shows why we typically trail in these kinds of markets.

First, the information technology sector was the second-strongest-performing sector in the S&P 500. Generally, we have had little to no direct participation in this sector, which features cyclical stocks whose cash-flow profiles do not necessarily support high and consistent dividend payments, increases and managerial commitment.

Next, the dividend-yield trend we noted a quarter ago (i.e., the market favored high dividends), reversed itself in the first quarter. Stocks that began the quarter with a dividend yield higher than that of the S&P 500 Index’s weighted-average yield performed about half as well as stocks with below-S&P yield, and about one-third as well as stocks with no dividend at all. For a dividend-focused strategy such as ours, this was a near-impossible headwind to overcome. More than 90 percent of our underperformance vs. the S&P 500 is attributed directly to our dividend-yield positioning relative to the benchmark.

Outlook

Many sectors of the economy are showing signs of gaining momentum. Automobile sales have climbed to a new

recovery high, albeit still below normalized pre-crisis levels. That has led to forecasts of vehicle production to be up 30 percent in the second quarter. Housing prices may not have turned the corner yet but we are seeing increasing signs of purchase interest from investors and foreigners. This is a very positive development, as any effort to soak up excess housing inventory will go a long way to stabilizing what is for most consumers their largest asset. The employment picture is also looking a little better as new filings for jobless claims dropped to the lowest levels since April 2008 and the University of Michigan jobs surveys have hit a new high.

There remain some headwinds. The second quarters of the past two years have not been kind to investors. In both years, the notion of a double-dip recession reared its ugly head. This year may be no different. Current worries that could lead to recession include increasing gasoline and food inflation, the end of the Fed’s “Operation Twist,” upcoming presidential and congressional elections, year-end expiration of certain tax cuts, ongoing Eurozone sovereign-debt pressures and accelerating U.S. fiscal deficits and debt. We believe those risks will continue to keep a lid on the stock market.

Despite the market’s solid first-quarter performance, we continue to believe there is an on-going valuation case to be made for U.S. equities. One metric that we follow is the ratio of the S&P 500 price index to corporate after-tax profits. Corporate profits have rebounded dramatically from the recent financial crisis but this ratio is currently at historically low levels. In fact, the last time we experienced a ratio this low was the high inflation and soaring interest-rate environment of the late 1970s.

We are not Pollyannas: We realize it is very unlikely for the market to increase in price unimpeded. That is why we still believe that being invested in high-quality, cash-flow-producing, dividend-paying stocks will help protect against downside risk and produce superior returns with lower volatility over the long haul.

The risks associated with Equity Income investing are based upon the identification of companies that possess both moderate growth rates as well as higher-than-average and consistent dividend distributions.

Please consider the investment objectives, risks, charges, and expenses of any fund carefully before investing. Contact Eagle at 800.421.4184 or your financial advisor for a prospectus, which contains this and other important information about the funds. Read the prospectus carefully before you invest or send money.

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Separately Managed Accounts (SMA):

Equity Income

Mutual Fund:

Growth & Income Fund

SMA Representative Holdings

JPMorgan Chase

ExxonMobil

Chevron

Abbott Laboratories

General Mills

Emerson Electric

Tyco International

Home Depot

PNC Financial Services

3M

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EFD-0412-905, Exp. 7/31/12