Eagle Small/Mid Cap Core

FIRST QUARTER | 3/31/12

EAGLE | Asset Management

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Separately Managed Accounts (SMA):
Small/Mid Cap Core

Mutual Fund:
Mid Cap Stock Fund

SMA Representative Holdings
Amphenol
IAC/InterActiveCorp.
Allied World Assurance
Wyndham Worldwide
Pall
J.B. Hunt Transport Services
Avnet
Graphic Packaging Holding
Aspen Technology
Avago Technologies

Market Overview
The Russell 2500 Index was up 13 percent this quarter, led by technology and consumer discretionary. Utilities (down 1.7 percent) lagged again. The index's smallest quintile by market capitalization was up 17 percent while the largest-by-size quintile was up 13 percent.

Portfolio Review
Eagle Small/Mid Cap Core portfolios slightly outperformed (on a gross basis) the benchmark Russell 2500 Index in the first quarter, with outperformance coming particularly from industrials and financials.

Materials were a source of outperformance from strength in the chemicals and packaging industries. In chemicals, Solutia was up after Eastman Chemical bought it. The deal is expected to boost Eastman's earnings immediately and will expand its emerging-market business. Solutia makes specialty chemicals and performance materials. We have liked the company for a while because it has had wide profit margins after selling its lower-profitability businesses during the economic downturn. Graphic Packaging was also up substantially after it had better paperboard margins than analysts expected.

Our only utility holding outperformed this quarter despite the market continuing to rotate out of the yield and stability of utilities. ITC Holdings was up slightly after it beat earnings estimates. Investors appear to be waiting for more clarity on the takeover of Entergy's transmission business to reward recent earnings strength.

Industrials were a source of underperformance as machinery and commercial services weighed on the portfolio. In machinery, Gardner Denver was down as the company had earnings results that were largely in line with estimates but volumes in their natural-gas pumps and fracking business were down. We sold the position. In commercial services, Waste Connections was a relative underperformer vs. its peer group.

Our financials holdings weighed down overall portfolio performance. Cash America traded off and we subsequently sold it because it appears to us it will face greater-than-anticipated headwinds from higher lending costs and headline risk surrounding the Consumer Financial Protection Bureau. There also has been more upfront cost than we expected with growing its installment-loan business. In diversified financial services, we sold Intercontinental Exchange because we believe it doesn't have the same upside as its peer NASDAQ OMX, which we bought this quarter.

Outlook
We continue to see a good value in the stock market with an average earnings yield still above the historical average and in spite of two consecutive quarters of double-digit returns. Furthermore, with an average 8 percent free-cash-flow yield for stocks and a 2 percent 10-year Treasury, we believe it's possible to invest in the skepticism of the market and earn a healthy return. In some regards, skepticism regarding the health of the companies that we invest in surprises us since pre-tax margins are at 40-year highs, according to Empirical Research. Barring an unexpected event that would shock the system, we don't see the trend of high margins subsiding as the globalization of our economy continues.

Looking out across the market, we also feel better as daily correlations among stocks have come down from record highs. That should cause stock selection to be rewarded, particularly in companies seen as growth names that still offer good risk/return profiles. Stocks with typically stable earnings and dividends appear very expensive to us and should be invested in with caution.

Consumer discretionary and information technology are the portfolio's largest overweight sectors. In consumer discretionary, we continue to be overweight media holdings, which tend to favor unique businesses that are very hard to replicate. Information technology is another sector that we are overweight since nearly the entire sector has been generating robust free-cash flow. We continue to maintain a market-weight position in energy, while we expect oil prices to act as a governor on domestic gross domestic product (GDP) growth. We believe it is best to own what we believe are high-quality exploration-and-production (E&P) companies.

Overall, we are underweight in financials, while maintaining a market weight in what we view as low-beta (i.e., risk) insurance companies and choose to underweight banks and REITs, mostly due to valuation. We continue to believe the utilities sector is expensive even with recent underperformance.

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.

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.