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Artio Global Management
Portfolio Co-manager

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Top Holdings

SPDR Gold Trust

Market Vectors

Royal Dutch Shell

Novartis

Sberbank

Barrick Gold

Unilever

Glaxosmithkline

Rio Tinto

Fraport

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Portfolio Review | Broadly speaking, developed market stock selection was a positive contributor to returns while positioning in both Japan and emerging markets detracted. In developed markets, stock selection was particularly strong in the materials and energy sectors and more than offset the negative impact the financial and telecommunications sectors had. Performance within the materials sector received a significant boost as a result of our gold-related holdings, including gold mines. While we benefited from our financial sector underweight position, including avoidance of banks in the troubled nations of Greece, Spain, Portugal and Ireland, the overall sector was one of the index's worst quarterly performers, and our holdings were not immune to the general downturn.

For some time we have been underweight the Japanese market, despite its status as one of the developed world's best performers this year. We continue to have reservations about the country's economy and feel that demographic, debt and political issues continue to plague the macro picture. Both our allocation and stock selection detracted from quarterly results. In particular, returns were hurt by holdings in the consumer discretionary, industrials and utilities sectors. Although the country has issued somewhat more optimistic economic reports, we still have concerns about the sustainability of domestic growth and our strategy will continue to look more towards companies we deem to be global players.

Our underperformance in emerging markets is largely due to exposure to Hungary and Russia which more than offset the positive effect seen from countries such as Brazil. Most of the negative impact in each of these two countries can be traced to a specific holding. In Hungary, it was exposure to one of the country's largest banks. The Hungarian market suffered a substantial drop during the quarter after the newly elected government issued a warning that a debt crisis similar to Greece could befall the country (which external economists dispute), hitting the banking sector particularly hard. In Russia, a steel producer was hurt by weak market sentiment but also fell when one of its major coal suppliers shut down after a mine explosion and price negotiations broke off with a pig iron supplier (a key raw material in steel production).

Given the tumultuous quarter and the euro's slide versus the U.S. dollar and most other major currencies, we defensively hedged a portion of portfolios out of the euro as pressure on that currency remains high. We also hedged some exposure in select emerging and smaller developed European currencies. These actions helped bolster returns.

Investment Strategy | While equity markets have continued to move lower in response to fears the economic recovery is weakening, our conviction toward long-term opportunities within the emerging world remains intact. With per capita incomes rising within emerging markets, the growth in spending is having an increasingly important influence on the profitability of select companies whose revenues are tied to consumers in China, India, Brazil and even sub-Saharan Africa. As a result of this unfolding story, we are strategically positioning portfolios to capitalize on these trends.

In developed markets, we continue to favor global leaders with strong brands - titans of industry - with export muscle into emerging markets. We have moved to an overweight position in European companies which we believe stand to benefit from their enhanced competitive position (given a weak euro), dominant brand power and market innovation. Many consumer-oriented companies in Western Europe fit this bill and are currently trading at large discounts to their emerging market equivalents mainly due to the effects of the sovereign debt crisis. This macro backdrop has provided us with an opportunity to invest in a wide range of companies that generate a big percentage of their sales from emerging markets, at attractive valuations. Companies involved in food production, retailing, household products, luxury goods, electronics and healthcare are of particular interest. For example, with increased demand for protein and more complex food products in emerging markets, we see opportunity not only in food and agricultural companies, but also in pharmaceutical firms as well. As the rate of diseases such as diabetes begins to increase with a more cholesterol-laden diet, we are drawn to those companies with the requisite drugs in their arsenal.

In addition to consumer-related companies, we find select capital goods and industrial companies attractive, including airport operators and those involved in trucking, logistics and electrical equipment. We have long been drawn to

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Benchmark Index:

The Morgan Stanley Capital International All Country World-ex US Index (MSCI ACWI-ex US) is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets.

Artio Global Investors is the subadviser to the Fund.

EFD-0710-462

the monopolistic structure of airports and favor those with large catchment areas, low but improving retail spending, sizable land banks for expansion and development, dual till vs. single till structure and reasonable valuations. Within the trucking industry, we look for leading manufacturers and suppliers who are expanding into emerging markets but can also benefit from improving truck volumes in North America and Europe given pent-up demand for trucks as the replacement cycle is now underway.

With regard to European financials, we are wary of the potential for another solvency crisis. Very few banks in Europe have taken on a convincing recapitalization program. Leverage remains extremely high and sovereign debt, while hard to pinpoint within the banking system, is a potential time bomb. As a result, we have limited our exposure to a few franchise banks which we view as higher quality, more exposed to retail deposit funding and more attractively valued.

Within emerging markets, in addition to several Chinese dairy and food companies, we have invested in several of that nation's consumer-oriented firms including the country's largest brewer, where growth continues to expand. This company is also the largest retail chain in China by sales and dominates the two richest provinces in terms of market share. Elsewhere in Asia, we favor the largest South Korean auto maker which has been taking market share globally. With less than 25 percent of this company's sales derived from Europe and North America, we find their more balanced sales composition a notable distinction within this industry. Technology is one sector in which Asia has a clear comparative advantage and as a result, is quickly achieving global dominance. Growing demand for consumer electronic products from emerging countries and increased cost consciousness of Western buyers are giving low cost yet innovative Asian producers an even stronger global foothold, leading to gains in market share. In addition, the information technology replacement cycle is supportive of equipment manufacturers and we have been drawn to several semi-conductor and computer companies in Taiwan.

In India, we favor companies leveraged to the country's long-term infrastructure build-out. Urbanization has emerged as one of the main challenges for developing countries, particularly in India and China, given the exponential population growth expected in these two countries. As populations increase and migrate towards urban areas, demand for basic products and services will likely increase necessitating major investments in infrastructure, particularly in India where infrastructure spending is far behind that of China. Given India and China's populations, these countries are becoming major drivers behind commodity prices. The resource-rich region of South Africa has attracted increased investment by Chinese interested in securing their long-term commodity needs. The injection of much needed investment into South Africa has led to increased consumer spending and our investment focus there, as well as other parts of sub-Saharan Africa, in various food retailers and pharmaceutical companies.

Within Central and Eastern Europe, we continue to favor Russia which appears committed to foster long term investment in the country. As the country works toward diversifying its economy beyond resources, we expect to see growth come from the consumer, benefiting food companies, retailers and banks. The government is also seeking to extend consumer borrowing by making loans more affordable. We were encouraged to see Russia's successful return to the international bond market in April with its issuance of \$5.5 billion of bonds, its first since defaulting in 1998.

Finally, as a hedge against currency debasement, we continue to be drawn to gold and gold mining stocks. Against the backdrop of a sovereign debt crisis in Europe and unprecedented levels of debt in the United States and other developed countries, we are maintaining our high single-digit weighting within this area.

International investing presents specific risks, such as currency fluctuations, differences in financial accounting standards, and potential political and economic instability. These risks are further accentuated in emerging market countries, where risks can also include possible economic dependency on revenues from particular commodities or on international aid or development assistance, currency transfer restrictions, and liquidity risks related to lower trading volumes. 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.