Eagle Quarterly Commentary

EAGLE Asset Management

Equity Income

Fourth Quarter | 2022

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Market Overview

Following a difficult first three quarters, the market as defined by the S&P 500 Index rebounded nicely during the fourth quarter, trading +7.6% higher. The market returned -18.1% for the full year. Over the past 40-plus years, only 2002 and 2008 were worse than 2022. Perhaps the biggest driver of this decline came from rising interest rates, as the federal funds rate rose from 0.1% to 4.4%. Similarly, Treasury yields rose from 1.5% to 3.9%, providing the primary catalyst for falling multiples. West Texas Intermediate crude oil prices also were volatile during the year, rising from $75.20 per barrel to a peak of $123.70 before ending the year at $80.30. All in, S&P 500 earnings estimates for 2022 started the year at $223.50 and finished at $220.50, a decline of only about 1.3%.

Portfolio Review[1,2]

The Eagle Equity Income portfolios outperformed the benchmark S&P 500 Index on a gross and net basis during the fourth quarter. Performance benefited from stock selection in consumer discretionary, information technology, and an underweight in communication services. Negatively, stock selection in utilities, financials, and a small cash position detracted from performance.

Energy performed well during the fourth quarter, with the sector up about 23%. Investors returned to the sector after the Organization of the Petroleum Exporting Countries (OPEC) signaled it would reduce production. Chevron reported strong quarterly results while buying back stock, paying a healthy dividend, and maintaining a strong balance sheet.

Merck reported strong third-quarter financials along with an increase in 2022 guidance. The company also announced positive phase 3 clinical trial results for a new drug to treat pulmonary arterial hypertension.

The longer-term dynamics of aerospace and defense returned to favor during the quarter, benefiting Raytheon. Management operated well despite announcing an uneven quarter.

Broadcom outperformed in the fourth quarter, driven by strong quarterly results and a positive outlook for 2023. The company also reiterated its confidence in closing an important acquisition of an enterprise software company by end of its fiscal 2023 year.

Shares of BlackRock outperformed as equity prices moved higher in October and November. As a reminder, the company benefits directly from market appreciation.

Dominion Energy traded lower following the surprise announcement of the company's strategic review. The company is likely to sell several business units, which will impact future earnings. As a result of earnings uncertainty, we decided to sell the stock.

Crown Castle underperformed due to higher interest rates and a slightly less constructive outlook for 2023. The company is seeing some pressure from non-renewals as a result of a merger between two major telecommunications companies.

Baxter reported soft third-quarter results and reduced its 2022 guidance to account for stronger currency headwinds and continued supply chain challenges.

Medtronic announced disappointing clinical trial results for a new product in its pipeline and lowered its fiscal 2023 financial guidance due

Top 10 Holdings

Chevron
NextEra Energy
Microsoft
Coca-Cola
Merck
Raytheon
McDonald's
Broadcom
Procter & Gamble
Target

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to lingering supply chain issues and slower than expected medical procedure recovery.

CME Group shares underperformed due to a decline in interest rates during the latter half of the quarter. Recall that a significant portion of CME's business benefits from higher interest rates and therefore the market's increased expectation for federal funds rate cuts in 2023 has weighed on the stock.

Outlook

The ongoing battle against excessive inflation by the U.S. Federal Reserve and other central banks is setting up to be a major factor affecting global economies in 2023. Starting with its first 25-basis point raise in March (from a base of zero), the Fed has raised the targeted federal funds rate seven times. This leaves the key banking rate at 4.25% to 4.5%, a level not seen since 2007. The yield on the 10-year Treasury bond rose from 1.5% at the beginning of the year to 3.9% at the end. Shorter-term notes have risen more dramatically, leading to an inverted yield curve, which tends to depress economic activity.

While there have been some encouraging disinflationary movements in certain commodities such as aluminum, copper, coffee, and cotton, inflation remains well in excess of the Fed's 2% target. The latest Consumer Price Index report in November showed a yearly all-items inflation rate of 7.1%, and a core (excluding food and energy) rate of 6.0%. The volatile energy segment led inflation for the year, with transportation services and food also growing at an accelerated clip.

Given higher inflation, higher interest rates, Federal Reserve monetary tightening, and recent consumer softening, it is no surprise that analysts predict a marked slowdown in real gross domestic product to 0.3% in 2023 versus an estimated 1.9% in 2022, and 5.9% in 2021. This estimate includes negative growth in third and fourth quarters of 2023 (the textbook definition of a recession). S&P 500 earnings estimates for 2023 currently sit at +4.6%. Given the risks in the economy, the expected earnings-per-share growth rate has been declining since the middle of 2022.

With the S&P 500 down -18.1% in 2022, the question becomes: Has the market adjusted for the risks we face in the near future? Surely many long-duration, high-multiple, volatile technology, communication services, and consumer discretionary shares have come back to earth after soaring in a COVID-affected world. However, if we have a repeat of the early 2000s' tech bust, many of these loss-generating businesses will not survive, at least not at unrealistic valuations.

Our discipline of investing in companies with free cash flows and a commitment to dividends and dividend growth served us well on a relative basis in 2022. Dividend growth can serve as a powerful hedge against inflation, and it seems that inflation is much more stubborn than many economists and strategists have predicted. We recognize that speculative fever will reoccur at some point in the future, but with the massive dislocations in the economy that still need to be corrected, we are happy to be invested in what we consider a high-quality portfolio.

1. References to specific securities are intended to illustrate the types of securities Eagle may hold in this portfolio. They are not intended as representations of specific investment recommendations that would have been profitable to an investor. Past performance is not a guarantee of future results. Opinions and estimates offered constitute Eagle's judgment and are subject to change without notice as are statements of financial-market trends, which are based on current market conditions. Investing involves risk, including the possible loss of principal.

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Equity Income

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	Top Securities	Average Weight (%)	Contribution to Return (%)	Bottom Securities	Average Weight (%)	Contribution to Return (%)
Equity Income	Chevron	4.64	1.13	Dominion Energy	1.41	-0.30
	Merck	3.38	0.92	Crown Castle	1.92	-0.13
	Raytheon	3.41	0.77	Baxter	1.67	-0.08
	Broadcom	3.08	0.77	Medtronic	2.05	-0.05
	BlackRock	2.44	0.65	CME Group	2.04	-0.04

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2. Source: Bloomberg.

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. There are risks associated with dividend investing, including that dividend-issuing companies may choose not to pay a dividend, may not have the ability to pay, or the dividend may be less than what is anticipated. Dividend-issuing companies are subject to interest-rate risk. High dividends can sometimes signal that a company is in distress. Historically, dividend yields have been relatively constant and therefore have created a cushion for investors when stock prices have declined. However, as with all equity investing, there is the risk that a company will not achieve its expected earnings results, or that an unexpected change in the market or within the company will occur, both of which may adversely affect investment results. The biggest risk of equity investing is that returns can fluctuate and investors can lose money.

The federal funds rate is the target interest rate set by the Federal Open Market Committee of the U.S. Federal Reserve. The target is the Fed's suggested rate for commercial banks to borrow and lend their excess reserves to each other overnight.

A multiple, sometimes referred as the price multiple or earnings multiple, is a measure of a company's value based on the ratio of its current share price to its earnings per share. This ratio is known as the price-to-earnings ratio, or P/E.

Basis points (bps) are measurements used in discussions of interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%.

A yield curve is a line that plots yields (interest rates) of bonds having equal credit quality but differing maturity dates. The slope of the yield curve gives an idea of future interest rate changes and economic activity. Investors and market analysts watch certain yield curves for signs of inversion, when yields for longer-term debt instruments fall below yields on short-term debt with the same credit quality. Inversions are watched as potential signs of a weakening economy and in certain cases, a harbinger of recessions.

Disinflation refers to the temporary slowing of the pace of price inflation and describes what happens when the inflation rate is marginally lower over the short term. Disinflation refers only to the rate of change in the rate of inflation. In this, it is distinct from inflation and deflation, which describe the direction of prices.

The U.S. Consumer Price Index (CPI) measures the change in prices paid by consumers for goods and services. The U.S. Bureau of Labor Statistics bases the index on prices of food, clothing, shelter, fuels, transportation, doctors' and dentists' services, drugs, and other goods and services that people buy for day-to-day living. Prices are collected each month in 75 urban areas across the country from about 6,000 households and 22,000 retailers.

Core inflation, as measured by the "Consumer Price Index for All Urban Consumers: All Items Less Food & Energy" is an aggregate of prices paid by urban consumers for a typical basket of goods, that does not include food and energy. Core CPI is widely used by economists because food and energy typically have very volatile prices.

Real gross domestic product (GDP) is nominal GDP, also known as headline GDP, adjusted for inflation.

Earnings per share (EPS) is calculated as a company's profit divided by the outstanding shares of its common stock. The resulting number serves as an indicator of a company's profitability.

Equity duration is the cash-flow weighted average time at which investors can expect to receive the cash flows from their investment in a company's stock. Long-duration stocks include fast-growing technology companies, including those that may not pay any dividends in their early years, while short-duration stocks tend to be more mature companies with higher ratios to dividend to price.

The S&P 500 Index, the strategy's benchmark index, measures change in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 75% of the investable U.S. equity market.

Indices are unmanaged, and one cannot invest directly in an index.

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Performance[2] as of Dec. 31, 2022

		Fourth Quarter	Year to Date	One Year	Three Years	Five Years	10 Years	Since Inception (July 1, 1981)
Eagle Equity Income	Gross	12.04%	-9.15%	-9.15%	7.63%	8.74%	11.36%	10.86%
Eagle Equity Income	Net	11.29%	-11.92%	-11.92%	4.48%	5.57%	8.13%	7.65%
S&P 500® Index		7.56%	-18.11%	-18.11%	7.66%	9.42%	12.56%	11.23%

The performance data quoted represents past performance. Past performance does not guarantee future results. Investment return and principal value will fluctuate so that an investor's portfolio, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance information quoted. To obtain current month-end performance information, please call your financial professional or visit eagleasset.com.

Performance Disclosures [2]

The calculation of the performance data includes reinvestment of all income and gains and is depicted on a time-weighted and size-weighted average for the entire period. Performance is shown after deduction of transaction costs and both "gross" (before the deduction of management fees) and "net" (after the deduction of management fees). Performance figures include all internal, retail Equity Income accounts of Eagle Asset Management, a St. Petersburg, Florida-based firm. Eagle Asset Management, Inc. claims compliance with the Global Investment Performance Standards (GIPS®). GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Eagle Asset Management, Inc. has received a firm-wide verification for the periods January 1, 1982 through December 31, 2021. Performance data for 2022 and the current year may be revised, and Eagle will publish any revised performance data. The compound impact on performance of the deduction of fees is determined by the account size, the amount of the fee, the time period and the gross investment performance. This compounding effect is generally reflected in the Annualized Performance chart. Because accounts are individually managed, returns for separate accounts may be higher or lower than the average performance stated in the charts.

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