Large Cap Growth

Second Quarter | 2019

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The risks associated with Large Cap Growth investing are that growth-oriented 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.

Market Overview

During the second quarter of 2019, the optimism from the first quarter continued, and, for the most part, equities rallied (or climbed a wall of worry?) across the globe, albeit with a sharp selloff in May.

In some ways, the weakness in the fourth quarter of 2018 set the stage for the recovery in 2019. Confronted by the market selloff, weaker economic data, risks to the trade outlook and low inflation, the Federal Reserve (Fed) and the European Central Bank (ECB) indicated that their next moves would likely be further monetary stimulus. Because of central banks' reaction functions, this year, bad economic news has been "good news" for markets.

Most economic data has yet to reflect a significant impact from the U.S. trade war with China, but that is unlikely to last if the stalemate drags on, and/or if the next round of tariffs kick in. An important question is whether or not the Fed has sufficient ammunition to fight a trade-related slowdown. Chairman Jerome Powell said the Fed was weighing a rate cut because economic "cross currents" have led to "greater uncertainty," but Powell added that he was "mindful that monetary policy should not overreact to any individual data point or short-term swing in sentiment."

While global growth remains positive, on average, it has become more uneven, and many major economies appear to have moved later in their business cycles. The United States is firmly late in the economic cycle, and while valuations are stretched, there is likely only low near-term risk of recession. However, macro events could quickly change our opinion. Valuations are more reasonable outside the United States in both developed and emerging market economies.

China's growth recession weighed on its export partners, but policy stimulus appears to have begun stabilizing the world's second-largest economy. That said, while China's policymakers stepped up the pace of stimulus this quarter, credit growth remains subdued, and the policy actions' ability to reaccelerate China's economy remains in question, implying high debt levels may still be inhibiting the government's actions.

Oil prices have fluctuated lately over a variety of concerns, including slowing global growth, disruptions to supply because of attacks on tankers in the Gulf of Hormuz, and U.S. sanctions on Iran. In addition, the potential for military conflict between the United States and Iran has increased macro volatility. Over the past 12 months, Iranian oil exports have fallen by 90%, much of that coming in the past two months. Markets would be well served by a de-escalation in bluster and violence.

The Fed completed the second round of its annual stress tests, which assess the nation's 18 biggest banks. The tests were created as part of the Dodd-Frank Act implemented after the 2008 financial crisis. The Fed found all 18 banks able to withstand a financial crisis, allowing them the flexibility going forward to increase dividends and/or repurchase shares. This is positive news as the flatter yield curve has challenged banks' profitability by shrinking the gap between lending rates and funding costs.

Like the rest of the world, we have no idea what is happening with Brexit. The story changes daily and is more unpredictable than ever. In times of such macro uncertainty, maintaining balanced portfolio positioning to the alternate outcomes, and the associated alternate risks, remains paramount.

Portfolio Review[1,2,3]

Over the second quarter, the Large Cap Growth portfolio underperformed its Russell® 1000 Growth Index benchmark. Stock selection was negative while sector allocation was negative to a lesser extent. An overweight to information technology and an underweight to energy helped performance, while an underweight to financials and an overweight to healthcare detracted from performance. Stock selection was weakest within consumer discretionary and materials but was strong in industrials and consumer staples.

At the start of the quarter, as compared to its Russell® 1000 Growth benchmark, the Large Cap Growth portfolio was most overweight the information technology and real estate sectors and most underweight industrials and communication services. At the end of the quarter, the portfolio remained most overweight information technology and real estate and was most underweight communication services and consumer discretionary. Within the universe of the Russell 1000® Growth Index, financials and materials performed the best, while energy was negative.

Microsoft posted yet another strong quarter, particularly from the cloud computing segment, and forecasted 10% revenue growth with stable operating margins. Its earnings and revenue visibility are attractive to investors during a period of heightened global economic uncertainty.

Amazon.com more than doubled profits mostly due to soaring demand for its cloud and ad services.

Apple is considering moving up to 30% of its China-based manufacturing elsewhere and intends to move ahead with the plan even if the U.S. and China reach an agreement.

Visa rose following the announcement that it signed up to back Facebook's new cryptocurrency, Libra.

Mastercard also signed up to back Facebook's new cryptocurrency, along with Visa and more than a dozen other companies.

Alphabet, the parent company of Google, traded lower after the company reported disappointing revenue growth. The stock was also hurt by news that the federal government plans to launch antitrust investigations into tech giants including Alphabet.

Kohl's plummeted ~12% after reporting earnings that came in below expectations. Kohl's attributed poor clothing sales to the rainy spring, but the firm also cut profit guidance for fiscal 2020.

PVH, which designs and markets apparel through Calvin Klein and Tommy Hilfiger, fell after releasing generally in-line earnings and softer-than-expected guidance.

Simon Property Group operates as a self-administered and self-managed real estate investment trust. The stock declined despite reporting earnings that exceeded the consensus estimate.

Palo Alto Networks engages in the provision of network security solutions to enterprises, service providers, and government entities. Despite another solid beat, the company's transition to cloud led to less multi-year contracts, resulting in a short-term hit to billings growth.

Outlook[2]

Stock investors have been on a wild ride the past year: Markets have gone from record highs, to being on the cusp of a bear market, to returning to recent peaks. This has left some investors feeling defensive as valuations appear stretched by some metrics. Conversely, many also worry about missing the next leg up in the now decade-long bull market.

U.S. stocks are hovering around all-time highs, kept afloat by hopes that the Fed will begin cutting rates as soon as its July meeting. Investors are questioning whether or not rate cuts will be sufficient to help what is ailing the economy.

Top 10 Holdings

Microsoft
Apple
Amazon.com
Visa
Adobe
United Health Group
Mastercard
Alphabet Class A
Alphabet Class C
Merck

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	Top Securities*	Average Weight (%)	Security Contribution to Portfolio Return	Bottom Securities	Average Weight (%)	Security Contribution to Portfolio Return
Large Cap Growth	Microsoft	8.30	1.10	Alphabet**	5.07	-0.43
	Amazon.com	5.83	0.34	Kohl's	0.71	-0.25
	Apple	6.60	0.32	PVH	0.58	-0.15
	Visa	2.79	0.31	Simon Property Group	1.05	-0.13
	Mastercard	2.45	0.29	Palo Alto Networks	0.67	-0.12

* as of June 28, 2019. The information provided above should not be construed as a recommendation to buy, sell or hold any particular security. The data are shown for informational purposes only and are not indicative of future portfolio characteristics or returns. Portfolio holdings are not stagnant and may change over time without prior notice. Past performance does not guarantee future results. Please note that the holdings identified do not represent all of the securities purchased, sold or recommended for the composite. They are provided for informational purposes only. Eagle, its affiliates or their respective employees may have a position in the securities listed. Please contact your financial advisor to obtain the calculation's methodology and/or a list showing every holding's contribution to the overall composite's performance during the measurement period.
** Combined A & C share classes.

Absent a comprehensive trade deal, it's difficult to imagine that many companies will be confident enough to expand capital spending, one of the primary reasons given for the 2018 corporate tax cut.

According to a June report from the World Bank, global economic growth is forecast to ease to a weaker-than-expected 2.6% in 2019 before inching up to 2.7% in 2020. Growth in emerging markets and developing economies is expected to stabilize next year, as some countries move past periods of financial strain, but economic momentum remains weak.iii

Similarly, the Congressional Budget Office (CBO) forecasts U.S. economic growth will slow to 2.3% for 2019 from 3.1% in 2018, as the effects of President Donald Trump's tax cuts fade and the federal budget deficit climbs to nearly $900 billion. The government's latest estimate for first-quarter GDP was unchanged at 3.1%. While any extremely long-term forecasts are to be taken with a large grain of salt, the CBO predicts that persistently large deficits will push federal debt to 93% of GDP in 2029, its highest level since immediately after World War II, and to about 150% of GDP by 2049.

In the United Kingdom, odds suggest that Boris Johnson is a strong favorite to be the next prime minister. Regardless, we believe parliament is still likely to prevent a no-deal Brexit, unless a general election or referendum takes place and provides a strong mandate from the population. At the moment, polls suggest only about 30% of U.K. voters want to leave the EU without a deal.iv Whoever it is, how the next prime minister hopes to solve the Brexit debacle remains to be seen.

The G20 meeting in June resulted in the United States and China agreeing to keep talking about trade, with no escalation in tariffs, but also without significant signs of progress. While the lack of further escalation avoids the worst-case scenario for the moment, the ongoing uncertainty and potential for a further breakdown in negotiations will continue to weigh on business sentiment. In addition, we've seen that new trade uncertainties can flare up at a moment's notice, including Mexico, Canada, India, and the EU. To date, the effects appear to have been relatively muted; however, the upcoming earnings season will provide new information.

Based on the 2019 rally, the fourth-quarter dip in stocks did little to dent investor confidence. Continued trade uncertainty and the potential for a limited Fed reaction could weigh on stocks in the near term, while an easing of trade tensions could keep the rally alive. Given an inverted yield curve, trade uncertainty, Brexit, and slowing economic growth, we believe investors need to remain disciplined and diversified and, as always, continue to avoid trying to time volatile markets.

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[3] Source: FactSet

[i] Reuters
[ii] Reuters
[iii] Bloomberg
[iv] Bloomberg