Eagle Insight

EAGLE Asset Management
AN AFFILIATE OF CARILLON TOWER ADVISERS

SMID Cap Strategy

Second Quarter | 2019

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Investments in small-cap companies generally involve greater risks than investing in larger-capitalization companies. Small-cap companies often have narrower commercial markets and more limited managerial and financial resources than larger, more established companies. As a result, their performance can be more volatile and they face greater risk of business failure, which could increase the volatility of a fund's portfolio. Additionally, small-cap companies may have less market liquidity than larger companies.

Market Overview[1]

The second quarter of 2019 was solid for small cap equities with the benchmark Russell 2000® index gaining more than 2% and increasing full year 2019 results an impressive 17%. Small caps lagged their large cap peers, and growth once again was preferred over value as the Russell 2000 Growth Index easily bested its value counterpart.

During April, the market continued its strong performance from the first quarter 2019. However, May saw significant drawdowns as concerns regarding global growth and heightened trade tensions became more pronounced. The market reversed course again in June as central banks in both Europe and the United States became more accommodative and hope for a resolution to trade issues improved. Despite strong gains thus far in 2019, market participants appear cautious as evidenced by the outperformance of large caps and defensive issues.

Portfolio Review[1,2,3]

The SMID Cap Strategy portfolio outperformed on a gross and a net basis vs. the benchmark Russell 2500™ Index. The majority of the outperformance occurred in April although the SMID Cap Strategy outperformed the benchmark Russell 2500 Index in the month of June as well (it slightly underperformed in May). We remain optimistic that its positioning with relative overweights toward companies with higher profitability, less leverage, and more stable earnings will again be rewarded.

From a sector perspective, we outperformed in the healthcare and real estate sectors, while we underperformed in the materials and industrials sectors.

We experienced solid outperformance in the healthcare sector for the second quarter. The primary driver of the good performance was a result of positive stock selection in the pharmaceutical and biotech and the equipment and services industry group. A leading contributor to performance in the period was due to the strong performance of Catalent (see below). We remain overweight the sector as we feel the demographic tailwind will continue to outweigh the political rhetoric in Washington. That said, we are mindful of legislation promoting a single-payer system, but also remain heavily exposed to companies that provide cost savings and process redundancy throughout the healthcare system.

Real estate investment trusts was one of our better performing sectors for the quarter due to strong stock selection. As in all sectors, we continue to favor high-quality niche businesses with solid balance sheets and strong management teams.

Our holdings in the industrial sector generated modestly negative attribution during the quarter due to one holding in the building materials industry as well as poor stock selection in the transportation industry. Overall the sector performed well versus the benchmark and our overweight position was a positive driver. We continue to think the sector offers attractive investment candidates.

Our holdings in the materials sector also generated negative attribution for the quarter due largely to stock selection in the specialty chemical industry. The sector underperformed the benchmark this quarter on concerns about the global economy and trade tensions. We continue to think there are attractive investment opportunities in this sector and we are comfortable with our overweight position.

Catalent provides advanced delivery technologies to the biotechnology and pharmaceutical industries. The company continued to put up steady results for the past quarter, but more importantly, we believe investors are beginning to notice the solid cash flow generation of the core business, while management strategically increases its exposure to its fastest growing segment, Biologics. In fact, Catalent received a positive stock reaction based on its recent acquisition of Paragon, a company focused specifically on gene therapy. Although Catalent can deliver volatile quarterly results, the yearly numbers tend to smooth out and the long-term growth numbers are in-line with our investment thesis. We maintain our ownership in this firm, as a way to gain exposure to the high-risk biotechnology industry with a much lower-risk alternative.

Medidata Solutions is a software platform that helps bring new products ranging from biopharmaceuticals to medical devices through the regulatory process, with the benefits of digitization and workflow automation. On April 22, media reports indicated that Dassault Systems was exploring the possibility of acquiring the company, which was proven true on June 12. The all-cash transaction at $92.50 per share represents a 34% premium from December 31 closing price of $67.42. The position has been a long-term holding for our portfolio and we were pleased with this result. We have since exited our position.

Steris develops and manufactures infection prevention products and surgical support systems for healthcare, pharmaceutical, research and government clients worldwide. The company produced another solid quarter with all four business segments delivering results slightly ahead of investor expectations, along with producing an overall 9% organic growth rate. Steris now has nearly 75% of its revenue in the recurring category versus a one-time capital equipment purchase, and the company is generating significant cash flow. The balance sheet is pristine, and we would not be surprised to see some inorganic investment, as management has communicated this and we feel confident in their execution. We continue to maintain and enjoy our position in this very steady business model.

Arch Capital Group writes insurance, reinsurance, and mortgage insurance on a worldwide basis. The shares outperformed driven by declining interest rates and better-than-expected first quarter accident year loss ratios (excluding catastrophe losses). We continue to own the shares as better market conditions in reinsurance and insurance can complement its mortgage insurance unit (which is doing very well). The company boasts a strong product portfolio, maintains an exemplary track record of premium growth, is making efforts to diversify its mortgage insurance business via strategic acquisitions and has very strong loss reserves.

Bright Horizons is the leader in the U.S. employer-sponsored child care market operating ~1,100 child care centers that care for ~120,000 children annually in the United States, the United Kingdom, the Netherlands, Canada and India. In addition, the company is the largest and one of the only multinational providers of back-up/elder dependent care services and also provides educational advisory services, tuition program management, education advising, and student loan repayment programs. The shares outperformed driven by strong first quarter results and full-year guidance. We continue to own the shares given the company's robust revenue growth outlook supported by favorable secular trends, a strong pipeline of new center openings, enrollment growth, tuition increases, cross-selling initiatives and improving margins from maturing lease/consortium centers.

PVH is a lifestyle company whose brand portfolio includes Calvin Klein, Tommy Hilfiger,

Top 10 Holdings

Catalent
STERIS
NICE
Arch Capital
Berry Global
Columbia Banking System
Laboratory Corp of America
Reinsurance Group of America
Qualys
POOL

The information provided above should not be construed as a recommendation to buy, sell or hold any particular security. The data is shown for informational purposes only and is 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.

SMID Cap Strategy

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Smaller Company Strategy	Top Securities	Average Weight (%)	Security Contribution to Portfolio Return	Bottom Securities	Average Weight (%)	Security Contribution to Portfolio Return
	Catalent	3.00	0.91	PVH	1.24	-0.33
	Medidata Solutions	1.58	0.45	A.O. Smith	1.64	-0.20
	Steris	2.75	0.45	Cimarex Energy	1.05	-0.19
	Arch Capital Group	2.55	0.37	Core Laboratories	0.67	-0.18
	Bright Horizons Family Solutions	1.80	0.33	LKQ	2.02	-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.

Van Heusen, IZOD, Arrow, Speedo, Warner's, Olga and Geoffrey Beene brands, as well as the digital-centric True & Co. intimates brand. The shares underperformed due to unseasonal May/early-June weather, Calvin Klein operational issues, ongoing U.S. tourism declines (35%-40% of U.S. retail outlet sales come from tourists), sluggish China trends and macro/tariff concerns. We continue to own the shares given Calvin Klein's turnaround initiatives, easier second half same-store sales comparisons, strong growth opportunities in Europe and Asia for Tommy Hilfiger and Calvin Klein and the potential for acquisitions (PVH's debt to EBITDA is currently only ~2x).

A.O. Smith manufactures water heating and water treatment equipment for the residential and commercial markets. The company's stock performed poorly during the quarter following an adverse reaction to a short report issued about the company. Specifically, the report called into question the company's relationship with its Chinese market distribution partner and the related impact this might have on inventory management and cash flow. Our team spoke with management, which indicated there were some problems with internal controls regarding this partner. While we are disappointed by the controls oversight, we do not think there is any impropriety and management is addressing the issue aggressively. We continue to own the stock and are awaiting details on management's actions plan for its business in China.

Cimarex Energy is an oil and gas exploration and production company. The company's shares performed poorly during the quarter despite posting reasonable first quarter financial results. Most companies in the energy sector saw their stock prices decline during the second quarter as commodity prices fluctuated due to demand concerns stemming from potential global economic softness and trade tensions. We continue to own the shares but remain cautious on the sector.

Core Laboratories is a leading specialty oilfield services firm. The company's shares performed poorly during the quarter despite posting reasonable first quarter financial results. Most companies in the energy sector saw their stock prices decline during the second quarter as commodity prices fluctuated due to demand concerns stemming from potential global economic softness and trade tensions. We continue to own the shares but remain cautious on the sector.

LKQ is a distributor of vehicle parts including new mechanical and collision parts, specialty auto equipment, and remanufactured and recycled parts in Europe and North America. The company's shares underperformed driven by concerns over LKQ's ability to improve its margin profile in Europe and drive low single-digit organic growth in North America. We remain shareholders given the secular shift to greater auto alternative parts usage (vs. new OEM repair parts) as well as the company's focus on integration/operations vs. additional acquisitions, margin improvement initiatives (continued optimization of its Tamworth 2 facility; the creation of a consistent product catalog across Europe vs. the 10 different product catalogs today; further procurement savings; the rationalization of $170 million in unprofitable, non-core assets; and a greater emphasis on higher margin private label parts) and LKQ's distinct scale advantage in both the

U.S. and Europe.

Outlook[2]

During the second quarter of 2019, equity markets continued to march higher in the face of growing concerns of slowing growth, continued trade tensions and geopolitical issues percolating around the globe. The bond market appears more cautious and is already pricing in several rate cuts as central bankers confirm their renewed commitment to monetary accommodation. Despite strong returns thus far in 2019, equity markets also appear to reflect some caution as evidenced by the outperformance of large caps, defensive issues and a lack of market breadth. We think this preference for high quality, stable growth companies will persist through 2019 as investors factor later cycle market dynamics into their investment decisions.

We are cautiously optimistic about equities in 2019. Central banks both here and in Europe are decidedly more dovish now than earlier in the year. The job market is strong, but growing wage pressures have yet to show up in inflation statistics. Chinese stimulus efforts are starting to bear fruit and we think the odds of a resolution to the U.S.-China trade tensions are improving given the looming 2020 election cycle on the horizon. Interest rates are supportive for growth and we expect to see continued slow and steady GDP expansion. We continue to monitor evidence of inflationary pressure building as well as European economic health.

Given that we are likely in the later innings of this economic cycle, we think our investment philosophy and process is well positioned. We think investors will continue to gravitate toward high-quality businesses exhibiting sustainable and profitable growth. Our long-term perspective and focus on security selection should serve us well in the current market environment.

We are overweight the technology sector and continue to be constructive in our outlook. Technology spending has been strong as companies push for continued efficiency and cost control amid ramping wage pressures. Valuations are reasonable in many parts of the sector.

Healthcare remains a focus area for the portfolio. Positive demographic trends continue to drive healthcare spending. We are closely monitoring potential changes to the Affordable Care Act and how that might affect our holdings in the space.

We are also constructive on the industrials and materials sectors. Steady growth and low interest rates bode well for these economically sensitive sectors. Positive resolutions to Brexit and trade friction with China would be tailwinds for these groups. We continue to find high quality businesses at reasonable valuations throughout these sectors.

While we see headwinds to earnings growth among financials stocks due to a flat yield curve, we remain neutral overall, as we believe the management teams have been more conservative in the past, and thus balance sheet and credit trends remain in good shape. To the extent that we see some excesses in the financial system, most appear concentrated outside of the regulated banking and insurance sectors. Relative valuations appear attractive and management teams are increasingly returning excess capital to shareholders.

We are cautious on the consumer sectors but are looking for opportunities throughout the space. The U.S. consumer is healthy given low unemployment, stable to rising wages and low interest rates. That said, there are numerous structural challenges in this area, and we remain disciplined in our search for differentiated business models.

Energy is another area of caution. The industry appears to be heeding investor demands for better capital discipline but the jury is out.

We remain underweight REITs and utilities. A low interest rate environment is a positive backdrop for these groups, but we remain on the sidelines given the lack of high-quality businesses. We are comfortable with our REIT holdings but remain on the sidelines in utilities due to valuation and undifferentiated business models.

We look forward to all the challenges and opportunities that 2019 will undoubtedly offer. We remain confident in our ability to find attractive investment options and build portfolios with well-managed, differentiated businesses. As always we thank you for your trust and confidence.

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3. Source: FactSet