

Muted optimism for continued growth

Carillon Tower affiliates' senior investment professionals offer informed perspectives on the current market situation and potential investment opportunities.

Executive Summary

- ▶ Carillon Tower brought together its affiliate equity and fixed-income portfolio managers and analysts to discuss ideas, events in the financial markets and potential opportunities for investors.
- ▶ U.S. markets stumbled out of the gate in 2016 but finished with a bang. A continued strengthening of macroeconomic data combined with a possibly easier regulatory environment could bode well for 2017.
- ▶ There always are risks — those that are anticipated and those that are not — to the markets but our affiliates' managers and analysts believe that, short of global recession, further growth is ahead.
- ▶ Carillon Tower continues to believe independent, diligent research and active management are paramount in constructing portfolios for long-term investors.

Carillon Tower Advisers recently gathered investment professionals from its affiliates — ClariVest Asset Management, subadvisor to three Eagle separate accounts; Cougar Global Investments; and Eagle Asset Management — to discuss market trends and how they are positioning their portfolios.

The U.S. equity markets shrugged off early-2016 concerns about a global recession and chugged along until the populist-driven summertime Brexit vote. The U.S. presidential election overhung the markets through the fall. The Federal Reserve made it two Decembers in a row of small interest-rate increases. The markets shrugged, though, and finished the year with a strong rally. The investment professionals' discussion included what 2017 might bring overall; the Fed's next possible move; prospects for the domestic economy as well as the increasingly relevant global economy; and — perhaps most interesting to readers — how they have positioned the investment portfolios they run.

Included in the most recent roundtable were James Breech, PhD (Cougar Global Investments); Priyanshu Mutreja, CFA (Eagle International ADR); Chuck Schwartz, CFA, and Jason Wulff, CFA (Eagle Smaller Company Strategy); James Camp, CFA (Eagle Fixed Income and Eagle Strategic Income Portfolio); Ed Cowart, CFA, and Brad Erwin, CFA (Eagle Equity Income, Eagle All Cap Equity and Eagle Strategic Income Portfolio); Bert L. Boksen, CFA, Eric Mintz, CFA, and Chris Sassouni, DMD (Eagle Small Cap Growth and Mid Cap Growth); and Todd McCallister, PhD, CFA (Eagle Small Cap Core). The moderator was Court James, executive vice president of Carillon Tower Advisers.

WHERE WE WERE: A LOOK BACK AT 2016

Court James, Moderator: *What are some of the things — sectors or themes — that worked for your portfolios and how, then, do you currently have those positioned?*

James Camp: I would suggest that 2016 — after stumbling out of the gate — was broadly divided into pre- and post-Brexit periods.

Financial conditions tightened pretty significantly as we started the year. It was a minor headline credit event because there wasn't a stampede of defaults but we had credit spreads (the difference in yields between U.S. Treasuries and corporate bonds of similar maturity) widen significantly after the U.S. Federal Reserve raised rates 0.25 percentage points in December 2015. To the average investor, that move should have been a non-event but the markets knew how much leverage there really is,

though, and shuddered. The Fed walked back talk of further increases — and nearly every other central bank subsequently did so as well — to pivot policy and calm markets.

We don't know how Brexit — Britain's vote to leave the European Union — will play out in the long term but the vote was consequential because it put central banks right back in the middle of the boat in terms of their activism. Post-Brexit, there were rallies in corporate and high-yield bonds. Municipal bonds continued to do very well even if they gave some of that back as the year ended.

Another story line of 2016 is that the Fed didn't see a reason to raise rates again meaningfully (the year's only move was a 0.25 percentage point increase in December). Our thesis throughout the post-Great Recession period is that the Fed is more focused on market behavior vs. hitting its stated

goals of attaining full employment and keeping inflation in check.

Bert Boksen: The four key issues of 2016 were Brexit, the rally in energy stocks, the U.S. election and the Fed. The first half of the year was dominated by high-dividend-paying stocks. The third quarter though was more of a “risk-on” market when technology did well but healthcare was a disaster and the fourth quarter rose higher into the end of the year.

Eric Mintz: In terms of 2016 surprises, tech has done great. Semi-conductors benefited from merger-and-acquisition (M&A) activity. Semiconductor demand for the cell-phone market has begun to flatten but other areas are picking up the slack, notably automobiles and industrial customers. We continue to believe that M&A activity will continue apace so this looks like a group that could continue to perform well.

On the negative side, the airline sector didn’t do as well as we expected with the dramatic pullback in oil prices. That said, a number of carriers have renegotiated labor contracts and are starting to see cost pressures that likely will encourage them to retire older planes, get capacity under control and get fares moving in a positive direction (for the companies). So, we were disappointed in the group’s 2016 performance but believe it’s set up pretty well for 2017.

Chris Sassouni: I believe the healthcare story of 2016 has been that we may have reached a point where out-of-pocket expenses — whether it’s employer-sponsored healthcare or buying insurance through exchanges — are forcing consumers to ration their own healthcare. We saw in the second quarter that physician-office visits were down 5 percent on a year-over-year basis and they were down 10 percent in the third quarter. So many negative earnings surprises — across different healthcare industries — have been attributed to weaker patient volumes. We have to figure out if this is the new normal.

“We continue to believe that M&A activity will continue apace so (semiconductors) looks like a group that could continue to perform well.”

— Eric Mintz, CFA

Here’s the dilemma: The average total premium for a family enrolled in employer-sponsored healthcare is \$18,000. The company is paying about \$12,500; meanwhile, the employee pays about \$5,500 and, on top of that, has a \$3,000 deductible. That’s more than \$8,000 annually just for healthcare. If

the average household income is roughly \$52,000 and the average monthly mortgage payment is \$1,100, healthcare spending is starting to squeeze expenses.

Jason Wulff: We had a better year in 2016. We made up a lot of ground early when volatility picked up and lower-quality, non-earning companies slipped. Going forward, we are moving even more toward what we view as a high-quality bias.

Relative valuations of higher-returning companies remain pretty attractive and we certainly like finding growth stories in this slow-growth environment

but we are very cautious about companies we believe are overly optimistic about demand growth. At the same time, we are being more diligent than ever about not buying cheap-for-a-reason underperforming names.

Brad Erwin: The first six weeks of 2016 didn't really make much sense: There was a sudden increase in recession fears, crude-oil prices hit a low of \$27 per barrel and markets panicked about global growth. So many macroeconomic factors created a maximum pain point in February. But then the market gathered itself and rallied 20 percent through August on the backs of many of the same companies it so heavily penalized in January and early February.

Perhaps more importantly, mid-February was when the domination of a handful of richly valued "momentum" stocks that had led the market

for nearly two years was broken. During that period, the average stock did much worse than the stock-market averages. That has been reversed since February.

We believe the current macroeconomic and market factors are going to remain in place. Recession fears have abated, global growth outlooks are improving (albeit slowly) and crude-oil prices are moving in the right direction. We remain somewhat optimistic on healthcare but are cautious on industrials and financials.

Ed Cowart: The first six weeks of this year were the worst-ever start to the stock market and they

were terrible for our portfolios. Since then, we've had a very good run. The average stock is doing better than the stock-market averages and that's the environment in which stock-pickers, which is what we consider ourselves, historically have done very well.

I don't see any significant macroeconomic changes in the short term. The economy appears locked into about a 2 percent growth rate. Some quarters may be a little better and some a little worse but I don't believe it moves dramatically in either direction

from here. The important thing is that corporate America seems to have learned how to turn slow economic growth into rising earnings and cash-flows. Further, a couple of the factors — the strong U.S. dollar and collapsed energy prices — that held back earnings for the last year or so are at least neutralized now.

“Corporate America seems to have learned how to turn slow economic growth into rising earnings and cash-flows.”

— Ed Cowart, CFA

James Breech: As a reminder, we look at the relationship between the behavior of asset classes and the global macroeconomic outlook. We favored U.S. stocks and bonds in 2016 though I would categorize our positioning as somewhat defensive. We moved some of our equity exposure from large-cap stocks to small- and mid-cap stocks as the dollar strengthened a bit.

I agree that the biggest story of 2016 was Brexit because it was, in our view, the beginning of the end of the era of globalization. This is a massive change for those of us who look at the global economy. Brexit — and likely also the later election of Donald Trump as U.S. president — also manifested the

global surge in populism. There was a time when portfolio managers could just ignore politics and politicians but we cannot do that anymore.

Another story is that we expected the decisions by the European Central Bank (ECB) and Bank of Japan to continue monetary-easing programs would drive down their currencies and, in turn, stimulate their economies. However, both currencies went up instead.

Priyanshu Mutreja: Things have been starting to look better. We are seeing emerging markets — places such as Brazil and China — beginning to stabilize. Clarity on the “new normal” for oil prices may give us more opportunities to pick stocks, especially in China where we are seeing some really good consumer-driven opportunities. Questions that remain include, What is the ECB going to do with its quantitative-easing program? And, How much confidence is there among investors about Japan’s ability to stimulate its economy?

ELECTION THOUGHTS

Moderator: *We will offer your thoughts in another paper on what a Trump administration may mean but did you have some quick reflections on the 2016 election?*

Camp: I think marginal tax rates were going to change — up or down — regardless of who won and I still believe that.

Mutreja: Some observers had suggested a Clinton win would imply Brexit was a one-off event and not translatable to a populism sentiment in the United States and the rest of the world.

Mintz: The Russell 2000 Index has been up about 15 percent in the last nine “first years” of a presidential term so we are hopeful that post-election trend continues!

WHERE WE ARE: IMMEDIATE OUTLOOK

MODERATOR: *How do you view the current landscape as we kick off 2017?*

“*We’re heartened by the fact that inflation seems to be moving in the right direction and the Fed was encouraged enough at least to raise rates a bit in December.*”

— James Camp, CFA

Camp: We give the U.S. economy a grade of C-minus but we’re heartened by the fact that inflation seems to be moving in the right direction and the Fed was encouraged enough at least to raise rates a bit in December. 2016 saw a continuation of the equity markets using the debt market to fuel M&A, higher dividends

and share buy-backs to ingratiate owners of companies vs. lenders of companies.

We don’t believe anything on the macroeconomic side has fundamentally changed. Brexit was, as I suggested earlier, a pivot point that put central banks right back in the spotlight. But, the Eurozone’s post-vote low yields were unsustainable and so we would expect to see a move back to the 2.5 percent to 3.0 percent range over the intermediate term.

It’s important to note along these lines that — in our view — monetary policy has become fungible. It

doesn't matter anymore, it seems, whether it's the Bank of Japan, the ECB or the U.S. Fed that expands or continues its easing program. Risk markets rally when any one prints money. The global interconnectedness certainly has played a role in the Fed moving with such deliberation in raising domestic rates.

The questions we face are:

- Will the bond markets continue to enable equity prices at these levels?
- What mistake will the Fed make: raising rates too much, too quickly and sending the U.S. economy potentially off the rails or letting the economy run as hot as it can for as long as it can?
- Will we at last see a handoff of economic policy from the monetary side of the equation to the fiscal side and will that reaccelerate growth?

Cowart: On an absolute basis, the market may be a little bit on the expensive side of average but we can still find attractively valued companies. And compared to fixed-income alternatives, stocks have seldom been more attractive with respect to the equity-risk premium; however, there remains a lot of money on the sidelines. We believe this is an environment where investors can get a better rate of return in equities vs. a lot of other places where they might put their money.

Breech: I think James has hit exactly on what we — and the markets — likely will still be talking about

well into 2017: How hot will U.S. Federal Reserve Chair Janet Yellen let the U.S. economy become? Is there a point at which the Fed decides it needs to disentangle itself from its central-bank peers?

It appears to us that the United States may raise rates — again, the issue is how much and how quickly — whereas the Bank of Japan and the ECB are both still in easing mode. If the U.S. dollar appreciates by, say, 10 percent over the next year, then that should stimulate Japan and the Eurozone relative to the United States. That might create

opportunities for us to invest more in those places.

We are also scanning the emerging-market universe; however, we are more cautious there for two reasons: The lack of clarity as it relates to corporate governance and our belief that we are unlikely to see the kind of rapid growth that we

have seen in previous cycles.

Todd McCallister: I believe the U.S. market really is the best place to be currently. There are structural issues in so many other places and it's hard to grow in the shadow of those problems.

I believe value stocks remain cheap and stable stocks are not because there still are concerns about some macroeconomic event that could dampen global growth, including that of the U.S. economy. Caution remains paramount.

Boksen: I believe the biggest surprise of 2017 could be a rip-roaring bull market. Market sentiment is incredibly bearish and the naysayers cite things we have discussed: negative yields, China, slowing

“*The biggest surprise of 2017 could be a rip-roaring bull market. Sentiment is bearish ... but sentiment usually is a pretty good contra-indicator!*”

— Bert L. Boksen, CFA

economic data. But sentiment usually is a pretty good contra-indicator!

Schwartz: We believe healthcare still offers some real opportunities though caution there is paramount. We also like what we view as higher-quality energy and industrials companies. In financials, smaller companies have some advantages over their larger-cap brethren and we are being diligent in trying to select companies with what we believe have realistic, well-measured growth plans. We are underweight in the consumer space because of the headwinds retailers face and also because some of the staples names have been treated as “bond proxies” and could suffer as interest rates move up.

WHAT TO LOOK FOR IN 2017: CHINA

Moderator: *How should we view — and make investment decisions about — the Chinese economy?*

Mintz: It’s still very hard to get consistently credible data out of China. I’ll ask 10 companies at a conference for their outlook on China and I’ll get just about 10 different answers. That said, it appears that China’s gross domestic product (GDP) essentially tracks its producer price index, which is driven largely by commodity prices. So I believe China’s economy is going to continue to surprise on the positive side unless we see a sharp decline in oil prices.

Mutreja: There have been concerns since 2008 — when China was seen as the world’s nearly singular

growth engine — about what exactly was going on there because it could have such a big impact on the rest of the world.

We keep close tabs on China. We believe there remain some compelling investment opportunities as the country seemingly has learned from its mistakes and is implementing new policies. In the end, its central bankers are in the same position as the Fed: trying simultaneously to stimulate growth while not overheating the economy. It has the history of other central banks to look at but it still must navigate these new waters on its own.

“We keep close tabs on China ... [which] seemingly has learned from its mistakes and is implementing new policies.”

— Priyanshu Mutreja, CFA

I don’t believe we have to worry so much at this point about a “hard” or “soft” landing — the concern for a few years — in China. People finally seem to be realizing that growth will continue in China but it will be slower. A growing consumer class is buying such things as automobiles. And there are

real innovators there. China no longer reverse-engineers or only assembles its exports. They have world-class companies competing on a global scale.

Boksen: Not investing due to fear can be costly. China supposed has been on the brink of “blowing up” for the last seven years and yet all I can think of is all the money that would not have been made if one had stayed on the sidelines due to concerns about what China might or might not do.

Breech: Our research basically agrees with the viewpoint that China is recovering slowly primarily because of government-directed stimulus, which likely is just as unsustainable as the great growth

China experienced a decade ago. But I believe market-watchers may spend too much time and energy worried about what's going on there. The fact is, the United States still has the largest economy and the most important as it relates to capital-market behavior.

More than 80 percent of U.S. GDP growth is from domestic consumption. U.S. labor growth is pretty good and income is increasing slowly but consumption growth is not as strong. That's a far bigger conundrum to me than what exactly is going on with the Chinese economy.

WHAT TO LOOK FOR IN 2017: BIG RISKS?

Moderator: *What major risks, if any, do you see on the horizon?*

Sassouni: My "black swan" is what gets done with Obamacare. We've probably slowed the march toward a single government-payer healthcare system with Trump's election but the program needs to be addressed. Trump has suggested making changes at the margin and it will be interesting to see what Congress and he decide to do. Simply repealing Obamacare inevitably will lead to all kinds of unintended consequences but something must be done since the program in its current state isn't economically viable. That's a very unattractive situation when you're talking about an industry that currently represents 18 percent — and on its way to 20 percent — of U.S. GDP.

A compounding factor, as I discussed earlier, is how more and more of the financial responsibility for

healthcare is being pushed down to the consumer. It's going to reach a breaking point where, in fact, the consumer will decide to purchase only catastrophic coverage (and hope for the best) or not buy any insurance and simply go to a non-profit hospital's emergency room where they can't turn away patients. Either way, it's not a very attractive situation for patients or healthcare providers.

McCallister: I wonder about what might happen with, for example, mega-cap global financial companies such as Deutsche Bank, which may still have toxic paper on its balance sheet. Could we repeat a Lehman Brothers situation from 2008, which rippled through global markets? I believe there could be some risk that isn't fully accounted for in the market considering that Deutsche Bank is a large systematic institution.

“*Repealing Obamacare inevitably will lead to all kinds of unintended consequences but something must be done.*”

— *Chris Sassouni, DMD*

Camp: Deutsche Bank is a problem credit in the troubled Eurozone. I would suggest, though, that Germany already has nationalized the company in a de facto manner. And if Germany hasn't, the ECB likely would have to since it's buying sovereign bonds and the banks are also buying sovereigns. It's become something of an Escher sketch where the two hands draw each other.

Mutreja: Deutsche Bank has been a concern for us as well since it is a global competitor. It is true that the path for what to do with it is unclear and uncomfortable for European leaders. One side suggests there's no way Germany would let it fail because it is, after all, Deutsche Bank. The other side suggests that Germany (or the ECB) can't bail

(continues on page 12)

RETURN OF ACTIVE MANAGEMENT

Camp: Maybe this is the environment that active managers such as we are begin to shine again, when having passive investments doesn't work as well if everything no longer moves in lockstep.

We've experienced massive macroeconomic correlation as central banks have lifted all asset classes. Maybe now, as central banks begin to sunset some of that accommodation, it will become more clear what companies have — and have not — done with capital. It's an admittedly small data set so far but it appears active managers have fared decidedly better in the last several months than they have over the last four or five years.

On the bond side, I believe it is more straightforward to outperform an index-tracking basket for a variety of reasons, including security selection and trade execution. On the contrary, it is extremely difficult to replicate the investment strategy with ETF portfolios. We believe it's much better to be in the honest-to-goodness bonds with our selection relative to an index.

Assets such as high-yield have attracted a lot of assets to ETFs that track the junk market but those funds don't — they can't — accurately trade in the same breadth or volume as the indices they track. I believe that sets up potential trouble when we have the seemingly inevitable liquidity events.

ETFs, particularly on the debt side, are late-cycle phenomena to me. Investors see a bull market and they view these vehicles as cheaper and easier ways to get in on the party. And the ETFs can and do track for a while. My concern is what happens when the music stops: Will there be enough

“liquidity chairs” for everyone to find a seat?

Cowart: I think the ETF boom simply has been a normal and — in retrospect — perhaps understandable reaction to the difficult period that active managers have endured the last four or five years. Those of us who have done this for a long time know that this is a cyclical phenomenon. This is not the first stretch — nor will it be the last — when the average active manager has struggled. These periods happened in the '70s, '80s and even in the '90s and I heard the same thing as I hear now: talk of the death of active management.

I believe the proximate reason for the acceleration of interest in ETFs is the average investor thinking, “Well, if active managers can't outperform, why should I pay bigger fees when I can get the same market exposure at a fraction of the cost?”

The reality of ETFs is that investors are locking themselves into always underperforming the benchmark indices simply because of that broad, buy-everything exposure and fees. These cycles end and active managers can — and many do — deliver outperformance to long-term clients. We may be coming to another cycle end now but we never know when exactly that happens until it's occurred. We may have a better handle on that as we move through 2017.

McCallister: When the market is good, who cares what you buy? Go buy an ETF. The ETF providers have displaced some historical Wall Street kings such as Goldman Sachs, which has changed the dynamics of how liquidity is provided to our markets. We haven't seen how that plays out when money flows out of those funds.

Mintz: Our business tends to be very cyclical but one constant is that investors chase performance. Hedge funds had a heyday and ETFs are having theirs now. This could go on for several more years but it is undoubtedly making active management easier. Competing against people who put money to work simply based on weights in an index makes what we do easier over time. Because when the tide inevitably turns, people will see the outperformance active managers can provide over time and will chase that back to us.

Boksen: It will be critical for active managers to be active in their space. Those who are “closet indexers” will not be able to separate themselves from ETFs. Others have said we haven’t yet seen how ETFs perform in a generally down market but we have seen how some can become temporarily dislocated from their underlying stocks. Some leveraged ETFs, particularly small-cap ones, got totally out of whack in the 2013 “flash crash” when they were trading but some of the component stocks had been halted.

Mutreja: ETFs are not as well-developed for international markets but we are seeing more proliferation with somewhat related phenomena such as robot advisors. The concern there is the same as it is for ETFs: What happens if there is a crash or a strong correction like what happened in January 2015? How do the ETFs react? How do their investors react?

We believe active management will come back in favor. The key for us — and it’s something that ETFs cannot do when they simply buy to mimic indices — is to pick good stocks and try to manage overall risk in portfolios.

Breech: I think it’s important — because of how we manage our portfolios — to make a distinction between passive investing and ETFs. We are active managers who use ETFs.

We have particular reasons for using the ETFs we employ. For instance, there are humans who manage the ETFs we use and who trade the fund’s underlying holdings throughout the day to keep its performance in line with the market. We avoid ETFs that use any derivatives since we want to own the physical securities as much as possible. We mostly can in the equities markets but there are too many fixed-income securities to own all of them. However, we are well aware of the methodology that our bond ETF provider uses to track those indices. In fact, we have an analyst who spends a lot of her time examining index-construction methodology and on the various ETF providers.

That is so important to us because we are asset allocators. We need accurate index data when we do our initial modeling so we can see how the indices behave under different scenarios: growth, inflation, recession and stagnation as well as under conditions that we call chaos (or what we’ve discussed here as “black swan” events). Those events are, by our definition, external to the economy (e.g., the Sept. 11, 2001, terrorist attacks or the Japanese tsunami). We look at how these asset classes behave under those scenarios and then we make the monthly asset-allocation decisions for our portfolios.

In sum, I’d suggest that “active management” and ETFs are not mutually exclusive. We firmly believe there is value to be added by both macroeconomic, top-down global tactical asset allocation and traditional bottom-up security selection, particularly when used in conjunction with each other.

out Deutsche Bank because it allowed Italian and Greek banks fail. Both are valid points.

Camp: That feeds into the nationalism and populism that we talked about previously. There have been specific talks about creating a Eurozone-denominated bond that would be rated on the aggregated creditworthiness of the Eurozone. A large part of that discussion, I believe, is the recognition that the Eurozone may have to infuse capital into major institutions.

Financial risk is an important topic because the “systematically important” institutions are not banks anymore. They are what I would describe as the “shadow banks” and exchange-traded funds (ETF) providers. The stampede into passive investments we have seen over the last decade has created — in our view — major systemic risk that we are not regulating.

On the other hand, we have overregulated commercial banks, which now have massive excess reserves but small loan growth. An essentially 0 percent interest rate for eight years has consequences and risk-taking behaviors have changed. Now, we’re all left trying to see where and when the real problems emerge.

McCallister: These global macroeconomic issues matter even to someone who only invests in domestic equities and here’s how: There are a group of stocks that are fairly cheap but are all subject to macroeconomic risk. There is another group of stocks that are pretty stable and may even have some growth potential but they are selling well above the market multiple.

The trick is to thread the needle between the cheap stuff that could explode if macroeconomic

trends tank or the expensive stuff that isn’t all that attractive on many long-term metrics.

Wulff: Indeed, we believe the key is trying to find those stocks that are misclassified. Maybe it’s not buying those companies that have been labeled “bond proxies” but don’t offer real stability. Maybe it is buying companies with stable business models even in sectors that, more broadly, are viewed as risky. Those companies do exist and it is our responsibility to find them.

WHERE ARE VALUATIONS?

Moderator: *Are valuations — in your view — currently too high, too low or just about right?*

Mintz: Small-cap stocks are attractively valued relative to large caps. The Russell 2000 Growth Index is currently trading around 17 times or 18 times forward earnings while the S&P 500 Index is trading around 16.5 times earnings. The Russell 2000 Growth historically trades at a 1.3 or 1.4 times premium vs. the S&P 500 so it’s at the lower end of that range. In sum, they’re not cheap but they’re currently not expensive on an absolute or relative basis.

Erwin: The S&P multiple currently is a bit high relative to its historical trend. But flipping over that ratio reveals a current earnings yield of about 5 percent level vs. a 10-year bond at about 1.8 percent. We believe earnings yield matters and it’s nice to see this current phenomenon since bond yields were higher than those of the S&P 500 from 1980 to 2005.

Wulff: Free-cash-flow margins generally have been good so I believe we have seen that become a more dominant and relevant statistic. This topic is why

it's important to look at individual companies vs. broad index averages. If you pull out non-earners and look at the companies actually generating cash, we believe the valuations for those are not out of whack on an historical basis.

Schwartz: The nice thing about 2016 was that the market actually began to reward again those managers who do pay attention to valuation.

Mutreja: On a global view, the U.S. markets look more expensive vs. international markets. Developed and emerging markets had a big rally coming off of the bottom and whether that continues remains to be seen. Brazil, with some clear issues, was one of the cheapest markets starting 2016 but had a strong 50 percent to 60 percent rally. It shows we are seeing better value in some European and emerging markets.

FOCUS ON FIXED INCOME

Camp: The bond market to us is getting a little more interesting again. It will take a little while but we are seeing some movement in the right direction. In the short term, we believe bonds could continue to rally for all the wrong reasons. We don't believe the credit market is fundamentally improving; in fact, we believe quite the contrary but we are in a global market for capital. We have overseas interest rates now off of zero, which was absurd, bewildering and bizarre. Some of the moves from negative real rates to zero were painful and they pushed U.S. interest rates higher. But I believe the bond market has more room to work now in 2017 because rates have backed up and there's been some giveback in the municipals market.

There is a natural governor on global interest rates, though: Central banks are not completely letting up on the easing levers they have used; further, the United States is still generally viewed as "safe-haven" asset with a nominal return relative to other debt instruments.

The municipal-bond market is its own animal. Credit quality is becoming very, very good in many places and every pullback in the municipal market that we saw in the third quarter of 2016 was a terrific opportunity for tax-sensitive investors to

become involved. Municipal bonds are a retail market: The Fed doesn't buy munis; retirees do.

This may sound counterintuitive but we believe municipal bonds will remain just as attractive even during a Trump administration that has said it will lower the uppermost

tax bracket. Why? The ultra-wealthy aren't the biggest cohort of municipal bonds; instead, it is middle-bracket taxpayers who likely won't see much in the way of income-tax relief.

I will repeat what I have said for the last several years as it relates to those who are building bond portfolios simply to chase yield: It is dangerous to be singularly focused on that. I believe we've hit an inflection point with interest rates so it is important to be very, very careful there. I believe this is a time when active management in the bond space can do very well when the market does an about-face or rates change directionally.

“*The Fed is going to tighten too quickly or it's going to leave rates too loose too long.*”

— James Camp, CFA

I mentioned earlier that the Fed is going to tighten too quickly or it's going to leave rates too loose too long. I'm of the belief this Fed wants to leave it loose as long as it possibly can because inflation is ultimately the only thing that globally gets us back to some sort of equilibrium with the massive debt that is out there.

Boksen: I am concerned that — with U.S. GDP growing only about 1.5 percent annually — that the Fed would consider raising rates. Europe is weak, the U.S. consumer is weak and auto sales are peaking. Housing may bail us out if millennials are starting to buy but we're eight years into an expansion and still not far away from negative growth.

Camp: I believe — and probably many people believe — that economic normalization should have occurred two years ago. But instead, the economy appears caught in a loop: Markets get the sniffles and sell off, credit spreads widen and central banks stand down. That's continued for the last three or four years even when the economy has met the Fed's stated employment and inflation targets. The Fed should have normalized two years ago. It didn't and now it's in something of a box.

"Wealth effect" matters. The virtuous cycle that begins when consumers spend their money because they're confident that their financial future is bright won't happen if people don't trust markets. We have seen that in reduced consumption.

I believe Washington should relax capital guidelines and other regulation that likely went too far after the Great Recession. Let banks lend, let credit-creation happen for those who are financially

responsible. The current issue isn't the cost of money — it's still essentially free — but, rather, the availability of credit.

Moderator: *What, if anything, does the Fed do with interest rates in 2017?*

Camp: I believe we will see rates lower for longer. I may sound like a broken record but I believe that the Fed's view is that the global environment is more important than what exactly is happening with the U.S. economy.

Savers likely will continue to subsidize on some level a rally in risk assets. That becomes — if it already hasn't — a vicious circle: People who are experiencing increased healthcare costs or haven't had robust investment or saving returns believe they can't spend; those who have benefitted from the financial markets see a slowing economy and believe they shouldn't spend; and corporations, in turn, won't invest in meaningful expansion.

Cowart: Historically, rising interest rates haven't been a negative for the economy when inflation has been as low as it is now. I don't believe getting the short-term rate to 1 percent or even 2 percent would derail the economy; in fact, a feeling of getting back to "normal" may help instill broader confidence in the economic recovery. What is certain is that negative and zero percent interest rates aren't normal.

Moderator: *How do those who need income get it in this environment?*

Camp: I would remind people that if the 10-year Treasury is at 1.80 percent, someone buying a product designed to yield 6 percent is investing in something more than three times as risky as that

Treasury and that historically has not ended well. Getting into an investment product based solely on the “marquee yield” is dangerous because there are so many ways to create that yield.

This is not a time to follow those simply reaching for yield. We’re starting to see that in some of the higher-yielding dividend programs, which struggled mightily in the year-end interest-rate backups.

I believe investors should consider income-generation in a tactical way. It’s currently OK to have cash because the opportunity cost isn’t high.

The stock market is near all-time highs; the bond market similarly is close to all-time highs. They both can’t be right. We have had healthy cash balances in Strategic Income Portfolio (SIP) accounts, which has benefited from our ability to pursue income from good companies by way of bond or dividend yields.

We are currently more heavily allocated toward equities in our tactical portfolios. The income conversation between the bond and equity teams has been incredibly productive. Here’s a good example of pursuing the better source of income: AT&T has proposed issuing one of the biggest bond deals ever to fund its acquisition strategy. Based on the current yield of the common stock, I prefer passing the AT&T baton to the Equity Income team.

Erwin: One thing we have talked about forever on the Equity Income team — which, along with James and his Fixed Income staff, co-manages SIP accounts — is the importance not so much of a point-in-time dividend yield but, rather, dividend growth.

We also have seen what James talked about: High-dividend-payers, which became something of bond proxies, have struggled. We prefer to buy companies with the cash-flow capabilities to pay dividends and also to increase that dividend stream. The portfolios have performed relatively well as the highest-yielding companies in the market have come under increasing pressure.

Moderator: *What should investors consider before moving into bonds now?*

Camp: People who are naturally bond investors need income and capital preservation. We treat bonds as an asset category negatively correlated to stocks. Yes, investors could go into alternatives, unconstrained portfolios or derivatives but they don’t have to. We believe that if you have an authentic

bond portfolio — in either the municipal or taxable space — there’s no need to get into exotic products because, over time, bonds are a non-correlated asset.

I say authentic because it’s important for that portfolio to be an evergreen, center-of-the-plate bond portfolio and not simply a yield vehicle or “equity light” portfolio.

WHAT TO LOOK FOR IN 2017: GROWTH

Moderator: *What do you view as solid growth opportunities in 2017?*

Boksen: I could make a case for consumer discretionary stocks, which are setting up for very

“*The stock market is near all-time highs; the bond market similarly is close to all-time highs. They both can’t be right.*”

— James Camp, CFA

easy year-over-year comparisons in 2017. I don't think higher healthcare costs will really impact consumers because they likely will just walk away from insurance. And maybe healthcare could rebound a bit simply because the sentiment has been so negative.

Mintz: Energy is coming out of a depression while industrials are coming out of a recession; consequently, their year-over-year comparisons are easier going forward. I believe 2017 will be a positive year for those two groups as well as the related materials sector.

Sassouni: Biotech, which almost behaves as its own asset class (vs. being an industry in the healthcare sector), deserves comment. Investors increasingly are segregating non-biotech from biotech, which still presents opportunities — both positive and negative — that exist nowhere else in the stock market.

It is amazing to me the amount of money venture capitalists and private-equity funds continue to pump into biotech firms. It hasn't abated because they are making tremendous returns whether they take the firms public or sell them to pharmaceutical companies.

Moderator: *Healthcare may remain a political football but the increasing needs of an aging population are real. So what opportunities are there in the healthcare sector?*

McCallister: We have owned a company that is, at its core, an exercise program. Medicare Advantage obviously wants its members to get and stay healthy because that reduces its costs. So when someone signs up for Medicare Advantage, its representatives encourage enrollees to use our company's services. It may sound silly but it has been profitable and likely continues to see solid long-term demand trends.

Sassouni: There have been a couple of false starts but I believe we are going to see more "concierge medicine" where patients pay a monthly fee. Private equity has put money into that. This is similar to essentially what happens in a classic single-payer system, such as what is in Canada and

Europe. There are two tiers: There's the private, cash-pay healthcare system where you get to select your physician and the other is the stand-in-line-at-the-government-institute tier.

I believe we'll also see increased investments in data analytics. The U.S. government essentially forced hospitals and other healthcare providers to create and maintain digital records. So now the question is, What do you do with all that data? "Big-data analytics" may help make healthcare more effective in treating disease but also make it more cost-effective.

“*Consumer metrics are getting better: wages are creeping higher, we are creating jobs, housing looks pretty good, the stock market is up.*”

— Brad Erwin, CFA

Moderator: *What opportunities for growth are there in the consumer space?*

Erwin: The consumer discretionary sector really lagged in 2016 but we believe it may rebound in 2017. Consumer metrics are getting better: wages are creeping higher, we are creating jobs, housing looks pretty good and the stock market is up.

One of the things my colleague David Blount has said so often is that consumers — younger ones who are attuned to social media and older ones who no longer want to accumulate “stuff” — increasingly want to buy experiences over things. Memories will stay with you forever with the added benefit that others can share them.

A recent addition that fits this theme is a public cruise-line/vacation company. It sells at a compelling valuation, has a strong market share, generates a ton of cash and offers potential growth opportunities in the nascent Chinese market. A behind-the-scenes company that is in the same theme is a firm we own that, among other things, handles online reservations for the hospitality and travel industries.

McCallister: Millennials — and I am a parent of two — often would rather go someplace and take a picture of it than go to a store and buy something. Who knew the Great Wall of China was built so that vacation photos of it can be posted to Snapchat or other social-media sites? I kid, of course, but it’s a growing and likely sustainable trend.

Mutreja: Speaking of China, the automobile industry there has exploded. Auto sales have taken off but, perhaps more importantly, so has auto production by Chinese manufacturers. This ties back to what I discussed earlier: The Chinese aren’t just partnering

with the Volkswagens and Toyotas of the world; they are now starting to build their own cars to compete with joint-venture partners.

That’s one example of how “the consumer” exists in China and the companies that serve the consumer market are doing well. Companies that offer private education services also are doing quite well.

WHAT TO LOOK FOR IN 2017: ENERGY

Moderator: *Energy and commodities in general have had quite a ride over the last couple of years, taking the global markets along with them ... down and back up. What is the current outlook?*

Cowart: The biggest thing is that the Organization of the Petroleum Exporting Countries (OPEC) — but really, Saudi Arabia more specifically — has changed its tune. The day after Thanksgiving 2014, the oil-producing kingdom shocked the world by saying it was more interested in market share than maintaining prices.

It was obvious to many people that that decision was more about politics than economics. What Saudi Arabia was really trying to do was put the screws to their enemies Russia and Iran. And, as a side benefit, it thought it might knock out the burgeoning U.S. shale-oil production at the same time.

As it turned out, none of those things happened. It appears the only thing Saudi Arabia gained from its move was a huge budget constraint. Consequently, the Saudis decided to revert to cartel economics: Cut production a little bit and produce an outsized increase in price. OPEC agreed at the end of November to cut production but time will tell how many member nations will actually do so.

ALTERNATIVE ENERGY

Moderator: *Are there starting to be real investment opportunities — either directly or indirectly — in alternative energy?*

Cowart: It's important to start this conversation with a reminder that electricity still predominantly comes from hydrocarbons. The electricity used to charge battery-powered vehicles — which are slowly gaining market share, to be sure — isn't magically created in a house's walls. It comes from power plants that burn hydrocarbons — increasingly it is natural gas instead of oil or coal — to produce electricity.

Mutreja: We own a Danish company that builds wind turbines. Its long-term guidance has been pretty strong and I believe there is a lot of popular support, especially in Europe, for increased use of wind power and other alternative sources. And there has been talk in some places of banning sales

of gasoline-powered vehicles by 2025 or 2030. Clearly, though, having a plan and executing it often are two entirely different beasts.

Cowart: The most significant issue in the short to medium term is cost. Wind and solar are renewable and “better” on many levels but many places that want to be vanguards have come to realize those things currently cost a multiple of traditional energy sources.

Governments likely will have to help pay for alternative fuel sources — via outright subsidies or tax incentives — until the price of fossil fuels is equal to that of alternatives. The handoff is much easier at that point.

The other side of the energy equation is demand, which historically has increased by about a million barrels per day in the absence of a significant, global economic downturn. We already have a very narrow gap between supply and demand at this point and I believe those two will come together in 2017. I would not be surprised to see oil prices at about \$60 per barrel toward the end of the year.

The U.S. shale business can do very well with oil at \$60 per barrel. We have focused on those companies with the best resources, the best management teams and the best technical capabilities and that did pretty well for us in 2015. Longer term, shale is not the answer to the world's

energy problems. There are caps in production efficiency and, more importantly, there is a finite amount of resources. Consequently, the world will turn its attention back to deep, offshore resources.

The “Oil Age” may come to end in a couple of decades and the world will transition to whatever comes next. But we want to have exposure in the energy sector until then.

We believe the global integrated-energy companies have gotten the message not to overextend their investments but, rather, to be prudent and to share cash-flow with shareholders. Many of those companies are cutting operating expenses, which

also increases cash-flow, and producing 4 percent-5 percent dividend yields. We believe those yields in a \$60-per-barrel oil environment could grow 5 percent to 6 percent annually, especially with constrained capital spending.

We like some of the biggest oil-services companies because there is a tremendous amount of completion activity that is still on the horizon. There was a lot of consolidation in the industry that we believe will benefit the biggest companies, which likely will participate in an improving international market.

In the meantime, companies are taking out some drilling capacity. The newest, most high-tech rigs currently are being put to work but many other rigs — not viewed as best in class in terms of efficiency or safety — are being decommissioned. The industry is taking care of its capacity problem by sending a lot of those rigs to the scrap yard.

We're currently comfortable being somewhat overweight in the energy sector. There are a couple of seemingly immutable rules: Oil production always goes down in the absence of massive investment; meanwhile, demand always goes up in the absence of an economic downturn. The pieces are in place for supply and demand to come together.

WHAT TO LOOK FOR IN 2017: HOUSING

Moderator: *What is the outlook for housing, which seems to have re-emerged from the ashes of the 2008 collapse?*

Camp: Housing appears to me to be one of the real positives right now in the U.S. economy. Household formations are starting to pick up. Rents, particularly in multifamily units, have gone through the roof in many markets.

McCallister: Housing's current share of GDP is about 3.5 percent. The long-term average is about 5 percent and the highs — which we reached in 1950 and 2008 — were right at 7 percent. We're only at about half the level of the highs so I believe housing

still has a tailwind to return to its historical long-term average. Credit, though, remains tough for many potential homeowners to secure.

Camp: It is interesting, and perhaps a little scary, to note how well auto sales have gone while housing has recovered more slowly. The market for

secondary auto financing didn't stop after 2008-2009. In fact, it may be overly robust right now and particularly in the subprime market.

Meanwhile, the home-loan market for anybody with a credit-rating score less than the very top tier is very, very thin. The persistently low interest rates haven't helped more middle-class people get into homes and prices are appreciating quite a bit at the top end.

Mintz: I'm a little surprised household formations haven't been a bit stronger. The economy maybe hasn't felt as good to many people as stock-market averages might suggest. Also, increasing student-loan debt and weak wage growth hasn't helped. However, I have to believe there is a timeless quality to

“ I have to believe there is a timeless quality to the notion that young couples want a place of their own to call home. ”

— Eric Mintz, CFA

the notion that young couples, perhaps with their first child on the way, want a place of their own to call home. They want to buy a house instead of being cramped in a one-bedroom apartment or even living in their parents' basements.

Erwin: The housing market is locked and loaded for five years of 10 percent growth in the market just to get back to average. The challenge has been to find housing-related and building-products names at what we view as reasonable valuation.

Boksen: My frustration is that even companies in the sector that should be benefiting from this trend aren't. We own a homebuilder that exceeds earnings estimates just about every quarter but the stock hasn't really gone anywhere.

Mutreja: Great Britain's homebuilders generally did very well for a number of years because of the country's persistent housing shortage. After Brexit, there was a dramatic drop in homebuilders' stocks due to fears over access to credit and withdrawn foreign investment. The housing shortage — hence, demand — remains a long-term issue but those stock prices haven't yet recovered despite continued strong sales. It will be interesting to see how this plays out.

Property is a focus again in China. There is a different approach there than here because the government is much more directly involved in setting regulations. The current objective seems to be allowing more private ownership without, at the same time, encouraging speculative, multihouse purchases.

Breech: There are some housing markets in China that are overheating and other places where there is overbuilding. The state is trying to smooth that out a bit and it will be interesting to see if its efforts are successful.

ESG CONSIDERATIONS

Moderator: *Is ESG-focused investing (environmental, social and governance) gaining traction or is it simply a faddish extension of old-school socially responsible investing embraced by specific, limited audiences?*

Mutreja: This is another area where millennials may be embracing this notion more than their parents. They want to know that they are making money but they'd like to do good at the same time. We consider those things as well because we believe that companies that consider not just what they do but how they do it will have more long-term success than those that don't.

Wulff: The movement currently is stronger in Europe. There's still some confusion in the minds of U.S. investors about what it is exactly. It's not simply, "Don't invest in weapons, alcohol and tobacco." It's a broader approach to ensuring that potential holdings treat their employees, customers and communities properly.

Demand for this is growing but it's a challenge we gladly accept. We prefer to be stock owners vs. traders and — without even having a specific mandate to seek ESG-compliant firms — the companies we prefer to own based on their long-term fundamentals tend to be those that score well on those screens.

Schwartz: The risk-avoidance process dovetails perfectly with this. Companies that are good environmental stewards tend not to get sued. Companies that treat their employees well tend to retain quality workers. Those are positive for long-term success.

Erwin: We've added an ESG component to our investing process after realizing what a priority it is particularly for Eurozone clients. We use outside vendors to evaluate companies we may add to a portfolio. It has been a helpful exercise because it can reveal which companies really have a holistic view on their long-term prospects.

Mutreja: We believe the next evolution in ESG will be investors encouraging management to be socially responsible. This won't be through trying to control board seats but, rather, to engage firms in conversations to improve their operations as it relates to ESG issues. It may take some time for companies to focus more on long-term outlooks vs. meeting this quarter's earnings numbers but it can happen.

Cougar Global Tactical Strategy

James Breech, PhD

- Founder and CIO, Cougar Global Investments
- 32 years of investment experience
- BA, University of Toronto
- MBA, University of Pennsylvania
- PhD, Harvard University

Eagle Smaller Company Strategy

Chuck Schwartz, CFA

- 26 years of experience as a portfolio manager and analyst
- BS, University of Colorado (1985)
- MBA, University of Louisville (1989)
- Earned his Chartered Financial Analyst designation in 1999

Jason Wulff, CFA

- 16 years of investment- and finance-industry experience
- BS in finance, New York University (2001)
- Earned his Chartered Financial Analyst designation in 2008

Eagle Equity Income/All Cap Equity/ Value/Strategic Income Portfolio (SIP)

Ed Cowart, CFA

- 45 years of investment experience
- AB, Dartmouth College (1969)
- Earned his Chartered Financial Analyst designation in 1977

Brad Erwin, CFA

- 22 years of experience as an analyst and portfolio manager
- BS in finance, Miami (Ohio) University (1992)
- Earned his Chartered Financial Analyst designation in 1998

Eagle International ADR

Priyanshu Mutreja, CFA

- Eight years investment experience
- Eight years of experience with current team
- MFE, University of California, Berkeley (2007)
- BS, Valparaiso University (2009)
- Earned his Chartered Financial Analyst designation in 2013

Eagle Fixed Income/SIP

James C. Camp, CFA

- 28 years of investment experience
- BS, Vanderbilt University (1986)
- MBA in finance, Emory University (1990)
- Earned his Chartered Financial Analyst designation in 1993

Eagle Small and Mid Cap Growth

Bert L. Boksen, CFA

- 40 years of investment experience
- BA, City College of New York (1970)
- MBA, St. John's University (1977)
- Earned his Chartered Financial Analyst designation in 1981

Eric Mintz, CFA

- 22 years of investment experience
- BA, Washington and Lee University (1995)
- MBA, University of Southern California (2001)
- Earned his Chartered Financial Analyst Designation in 2000

Chris Sassouni, DMD

- 27 years of investment experience as an analyst and president of an independent investment research firm focused on healthcare as well as five years of experience with various healthcare companies
- BA (1979) and Doctor of Dental Medicine (1985), University of Pittsburgh
- MBA, University of North Carolina (1989)

Eagle institutional Small Cap Core Team

Todd McCallister, PhD, CFA

- 30 years of investment experience as a portfolio manager and analyst
- BA, with highest honors, University of North Carolina (1982)
- PhD in economics, University of Virginia (1987)
- Earned his Chartered Financial Analyst designation in 1996

Carillon Tower Advisers

Courtland "Court" James, Executive Vice President

- 18 years of financial-industry experience in investment banking, private equity and human resources
- BA, *magna cum laude*, Vanderbilt University (1996)
- MBA, Harvard Business School (2003)

About Carillon Tower Advisers

Carillon Tower Advisers provides support services, including marketing and sales, to affiliated advisers. Carillon Tower Advisers' affiliates (Eagle Asset Management, ClariVest Asset Management and Cougar Global Investments) manage a broad range of investment vehicles, including separately managed accounts, mutual funds, closed-end funds, UCITS and other types of products.



AFFILIATES:



880 Carillon Parkway | St. Petersburg, FL 33716 | 800.521.1195 | carillontower.com

CTA168-1/17 | Exp. 1/31/18

© 2017 Carillon Tower Advisers, Inc.

Past performance does not guarantee future results.

Opinions and estimates offered the judgment of the Carillon Tower portfolio managers quoted herein and are subject to change without notice, as are statements of financial-market trends, which are based on current market conditions. The meeting of these Carillon Tower's portfolio managers occurred Nov. 10, 2015; however, managers were allowed to update their comments to reflect current conditions prior to publication on Dec. 31, 2015. Under no circumstances does the information contained within represent a recommendation to buy, hold or sell any security and it should not be assumed that the securities transactions or holdings discussed were or will prove to be profitable. Any index is referred to for information purposes only; the composition of each index is different from the composition of the accounts managed by the investment manager. An index is unmanaged and has no expenses, and it is not possible to invest directly in an index.