CARILLON REAMS UNCONSTRAINED BOND FUND

CARILLON FAMILY OF FUNDS

INSIGHT | COMMENTARY

FOURTH QUARTER | 2018

Investment Team

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Characteristics

Total Net Assets (billions): $1.21

Number of holdings: 68

Top Holdings

TSY INFL IX N/B TII 0 3/4 07/15/28
US TREASURY N/B T 2 12/31/21
US TREASURY N/B T 1 5/8 07/31/19
US TREASURY N/B T 2 1/4 11/15/27
US TREASURY N/B T 2 3/4 02/28/25
US TREASURY N/B T 2 1/4 08/15/27
US TREASURY N/B T 1 1/4 10/31/21
US TREASURY N/B T 1 7/8 02/28/22
FNCL 3 1/19 FNCL 3 1/19
US TREASURY N/B T 2 1/4 02/29/20

Please consider the investment objectives, risks, charges, and expenses of any fund carefully before investing. Contact Carillon Fund Services at 800.421.4184 or your financial advisor for a prospectus, which contains this and other important information about the funds. Read the prospectus carefully before you invest or send money.

Market Overview

The Bloomberg Barclays U.S. Aggregate Index® returned 1.64 percent for the three months ending Dec. 31, 2018. Spread sectors steadily underperformed during the quarter. High-yield credit weakened the most, widening 210 basis points (bps). Investment-grade credit widened 47 bps. In structured products, commercial mortgage-backed securities (CMBS), asset-backed securities (ABS) and mortgage-backed securities (MBS) widened 27, 15, and 14 basis points, respectively. The Treasury curve shifted lower and intermediate maturities outperformed as the 2-, 5-, 10-, and 30-year Treasury yields declined 33, 44, 38, and 19 basis points, respectively.

Treasury rates experienced a sharp push to the upside in October after Federal Reserve Chairman Powell commented that we are "a long way from neutral." His remark highlighted the potential for an extended rate-hiking cycle, which the bond market thought was winding down. Higher rates also unnerved the equity market, which experienced several days of heightened volatility just as quarterly earnings season began in earnest. A few notable earnings disappointments, particularly in technology, further soured the market's mood.

Federal Reserve Chairman Powell reversed course in late November, declaring that rates were "just below neutral." This comment contributed to the subsequent reduction in interest rates and fueled criticism that the Fed has been reacting to market movements as much as economic data.

Meanwhile, prospects for strong economic growth in 2019 continued to wane. Lack of fiscal stimulus coupled with global political turmoil dampened expectations for the new year. U.S. midterm elections resulted in a Democratic-led House and a Republican-controlled Senate, creating the potential for at least two years of Washington gridlock. The government shutdown sparked by President Trump's demand for border wall funding suggested that heightened discord may become the new normal, further exacerbating the problem

Internationally, political tumult in the United Kingdom and the ongoing U.S.-China trade dispute intensified global uncertainty. British Prime Minister May was forced to withdraw her negotiated Brexit deal to avoid an embarrassing defeat. May was able to survive a subsequent no-confidence vote, but prospects for eventually passing a Brexit deal through Parliament appear remote.

A contemptuous ceasefire between the U.S. and China was negotiated late in the year, but significant trade issues remain. China offered the U.S. an olive branch in December, agreeing to reduce tariffs on autos and certain auto parts to 15 percent from the recently elevated level of 40 percent. However, a clear path to substantial improvement in the relationship has not yet become apparent and further pain is likely. China's capital markets have already suffered sharply, and while this sentiment took a little longer to hit the U.S., we saw the result in increased fourth-quarter volatility.

Portfolio Review

Macro performance factors added to performance due to the Fund's positive U.S. duration[1] position as interest rates declined.

Fund performance was largely positive at the sector level. Investment-grade credit benefited from relative outperformance in the Fund's defensive positions. Well-structured holdings bolstered CMBS returns, and multi-family agency holdings added value in the MBS sector. Treasury Inflation-Protected Securities (TIPS) added to Fund performance as this sector outperformed. In contrast, high- yield credit detracted due to the Fund's modest positions in this poorly performing sector. All other sectors had a minimal impact.

Capital markets moved from what we had considered overly optimistic to more reasonable valuations during the fourth quarter. Having anticipated a pullback for some time, we had been maintaining a high degree of liquidity in the Fund, patiently waiting to exploit attractive investment opportunities when they presented themselves. Widening spreads in the last two weeks of the year enabled us to do just that. We responded to the downward market acceleration by purchasing select high-yield and investment-grade credits that had finally become fairly valued.

Even with these purchases, we maintained the Fund's defensive positioning. Valuations have not yet reached the level where we would be comfortable extending our position on the risk spectrum. For that reason, the Fund's investment-grade corporate holdings remained focused in very short financials and industrials. Holdings in the MBS sector were primarily in seasoned super-senior CMBS, which have significant credit enhancement, and multi-family Agency MBS holdings, which have strong prepayment protection features.

We continued to view U.S. rates as attractive on a relative basis versus German bund[2] rates. Late in the quarter, we responded to lower U.S. rates by reducing Fund duration, but overall the Fund's duration position remained positive.

Outlook

We expect economic activity to be relatively sluggish in 2019. Continued Fed tightening is finally coming home to roost after flying under the radar for much of 2018, when it was overwhelmed by the fiscal stimulus of tax cuts and government spending increases. Challenges created by the exit from quantitative easing in the U.S., as well as final tapering in Europe, are just beginning to appear and likely will continue to weigh on economic activity.

Rising short rates, pushed higher by the Fed, have steadily tightened domestic financial conditions. With each Federal Reserve rate hike, the chance of policy error increases. The Fed's two projected rate increases in 2019 may prove to be optimistic as Washington gridlock makes further fiscal stimulus unlikely. The flat yield curve, with a long end that appears doubtful of an inflation spike, highlights the lack of consistency in outlook between market participants and the Fed itself. Meanwhile, growing budget deficits are heightening risk as the economy downshifts into a slower pace of economic growth.

In fixed income credit markets, the third quarter's elevated valuations proved to be fleeting. Despite technical tailwinds, corporate spreads widened sharply in the fourth quarter after hitting historically tight levels earlier in the year. We believe valuations in the corporate sector are now close to fair value, but they remain susceptible to sharp declines. Mortgage pass-through valuations have also become slightly more attractive, but have not underperformed as sharply as the corporate sector.

If the Fed continues down its stated path of raising the front end of the yield curve, the danger of further curve inversion increases. (The curve briefly inverted from two to five years late in the fourth quarter.) Any over-tightening by the Fed could have a markedly negative impact on future spread sector performance. For these reasons, we remain defensive, maintaining substantial liquidity in the Fund in order to capitalize on the next big market move when it occurs.

The Fund employs an unconstrained investment approach which creates considerable exposure to certain types of securities that present significant volatility in the Fund's performance, particularly over short periods of time. The return of principal in a fixed income fund is not guaranteed. Fixed income funds have the same interest rate, inflation, issuer, maturity and credit risks that are associated with underlying fixed income securities owned by the Fund.

Foreign investments present additional risks due to currency fluctuations, economic and political factors, government regulations, differences in accounting standards and other factors. Investments in emerging markets involve even greater risks.

Mortgage- and Asset-Backed Securities are subject to prepayment risk and the risk of default on the underlying mortgages or other assets. High yield securities involve greater risk than investment grade securities and tend to be more sensitive to economic conditions and credit risk.

Derivatives such as options, futures contracts, currency forwards or swap agreements may involve greater risks than if the Fund invested in the referenced obligation directly. Derivatives are subject to risks such as market risk, liquidity risk, interest rate risk, credit risk and management risk. Derivative investments could lose more than the principal amount invested. The Fund may use derivatives for hedging purposes or as part of its investment strategy. The use of leverage, derivatives, and short sales could accelerate losses to the fund. These losses could exceed the amount originally invested.

The Fund may, at times, experience higher-than-average portfolio turnover, which may generate significant taxable gains and increased trading expenses, which, in turn, may lower the Fund's return.

Short sale risk includes the potential loss of more money than the actual cost of the investment, and the risk that the third party to the short sale may fail to honor its contract terms, causing a loss to the fund.

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[1]Duration incorporates a bond's yield, coupon, final maturity and call features into one number, expressed in years, that indicates how price-sensitive a bond or portfolio is to changes in interest rates. Bonds with higher durations carry more risk and have higher price volatility than bonds with lower durations.

[2] A German bund is the German equivalent of a U.S. Treasury bond.

Benchmark Index

The BofA Merrill Lynch USD 3-Month LIBOR Constant Maturity Index is based on the assumed purchase of a synthetic instrument having 3 months to maturity and with a coupon equal to the closing quote for 3-Month LIBOR. That issue is sold the following day (priced at a yield equal to the current day closing 3-Month LIBOR rate) and is rolled into a new 3-Month instrument. The index, therefore, will always have a constant maturity equal to exactly 3 months. It is not possible to invest in an index.

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