COMMENTARY
Enhanced Equity SMA | 1st Quarter 2020

Our Enhanced Equity portfolio is designed as a product for investors who seek the long-term capital growth of equity markets and who are comfortable with the trade-offs inherent in selling call options against underlying common stock positions. To implement our strategy, we carefully construct a diversified portfolio of perceived high-quality stocks that we believe will appreciate over time. Then, we give others the right to buy those same stocks from us (we sell a call option), at a pre-determined price (the strike), at a pre-determined point in time (the expiration date). We forego upside in our stocks beyond the strike price, while the buyer of the call option gives us cash (the premium) for that right to participate in any share price appreciation beyond our chosen target. We write “out-of-the-money” options (meaning the strike is above the stock’s prevailing market price) that provide us both cash income up front (via the premium) and some defined appreciation potential to the strike price.

In essence, our call-writing strategy involves a calculated series of low-return but high-probability bets (a cash return up front is assured, while we “lose” versus a non-hedged portfolio only if our stocks advance beyond the strike price). The call buyer(s) on the other side of our transactions are making a series of low-probability, but potentially high-return, bets on each of our stocks. Over time, we believe the option premiums we are able to generate will “enhance” our underlying equity performance, while reducing overall volatility. We benchmark our portfolio against the CBOE BuyWrite Index, or “BXM.” BXM tracks the performance of an unmanaged strategy based upon writing at-the-money, one-month calls against the S&P 500 index. We seek to add value with our stock selection disciplines, and via active tactical management of our options exposures.

Performance

The Sterling Enhanced Equity portfolio returned -26.0% (gross) and -26.3 (net) for the quarter versus the -22.2% return for the CBOE BuyWrite (BXM) index and the S&P 500’s (SPX) total return of -19.6%.*

Winners & Losers

The portfolio featured several large movers given the extreme volatility in the first quarter of 2020. The largest five contributors in both directions are presented below.

Premier (+11%) rose during the quarter. Newly added Premier is the second largest healthcare Group Purchasing Organization, and is likely a beneficiary of the increasing demand for protective equipment for hospitals related to the coronavirus. Investors likely favored the strong balance sheet and potential for consistent cash flow of the business amid the uncertain economic environment.

Akamai Technologies (+6%) rose based on the company’s leading competitive position in content delivery network (CDN) services. The company’s solutions sit at the edge of the internet at different strategic points between end users. Given state/municipal stay-at-home orders to slow the spread of COVID-19, we believe Akamai is seeing increasing demand for its services as consumers substitute their normal activities for additional media (streaming, video games) and employees increasingly working from home.

Cabot Oil and Gas (flat) held up despite the collapse in the price of oil from the Russia/Saudi Arabia price war and expected demand destruction for oil from the COVID-19 crisis. As a low-cost natural gas producer, Cabot has significantly less exposure to the price of oil and maintains a relatively strong balance sheet. Cabot is committed to returning cash flow to shareholders with over $1 billion in dividends and share repurchases over the past two years.

Activision (flat) held up well, also largely because of stay-at-home measures associated with COVID-19, in our view. In addition, according to Cowen, “in both 2001 and 2008-09, the industry enjoyed healthy overall growth in both software and hardware sales despite a negative economic environment.” Finally, the company launched a “free-to-play” battle royale version of its *Call of Duty* title in hopes that it can replicate at least a portion of the success enjoyed by Epic Games’ *Fortnite* game.

Centene (-6%) declined less than the market as the managed care provider (following its acquisition of WellCare) now serves over 12 million Medicaid beneficiaries, which is well ahead of its peers. Given its success in Medicaid (80% Medicaid RFP win rate), we believe CNC will likely be a net beneficiary of the potentially robust increase in Medicaid enrollment along with potential for an increase in non-Medicaid customers.

**Past performance is not indicative of future results. Please refer to the performance disclosure found on page 4 for additional information.*

Norwegian Cruise Lines (-86%) fell extremely hard in the quarter, despite record profits reported in February. The stock was hit by media reports about the tragic COVID-19 outbreaks on two cruise ships; both were competitor Carnival's ships. Norwegian reported zero confirmed cases, but all cruise lines were impacted and eventually docked their fleets. With the duration of the epidemic unknown, the industry may need a bailout.

Delta Airlines (-63%) also was hit particularly hard in the quarter, as business and consumer travel ground to a halt due to COVID-19. As we did with Norwegian, we sold our Delta shares in the quarter out of an abundance of caution, given the possibility of prolonged weakness in travel and the effects that a government bailout may have on long-term shareholder returns.

Occidental Petroleum (-72%) fell extremely hard during the quarter with the combination of the Russia/Saudi Arabia oil price/production war and increasing concerns of the coronavirus's economic impact leading to demand destruction for oil. With oil prices tumbling below the $30/barrel range, even OXY's hedges likely would not allow the company to maintain its dividend, despite March 5th comments from Raymond James that "Management is extremely committed to the dividend." Five days later, the company cut its dividend by 86%.

Restaurant Brands (-53%) declined as social distancing is limiting consumers from congregating in public places, including restaurants. Restaurant Brands has warned of declining comp sales while vowing no layoffs during the pandemic. In late March, management reported: "Our business model has allowed us to maintain a strong balance sheet and we ended 2019 with ~$1.5B in cash. We have further fortified our balance sheet position by proactively drawing down our full $1B revolving credit facility out of an abundance of caution. As a result, we now have approximately $2.5B of cash on hand. This has provided us the flexibility to confidently support our restaurant owners and employees throughout this uncertain time and maintain our focus on supporting our brands for the long term by making the right decisions today." Though there will be substantial changes, including lowered capital expenditure obligations, advanced cash payments and rebates to restaurant owners, rent structure shifting to 100% variable, rent payment deferments, and more, we believe QSR can weather the storm with its current liquidity situation supported by a capital asset light franchise model.

CDK Global (-40%) fell as most of the country and much of the world is being directed to avoid large gatherings. Social distancing limits manufacturing operations and limits car sales at retail dealerships, which are CDK's key customers as a software company that helps auto dealers manage inventory and operations. CDK has proactively offered financial assistance to its dealer base for the month of April due to the COVID-19 crisis with a temporary reduction in subscription fees as well as suspending costs for non-used products for two months. With 75-80% of CDK's annual revenue being subscription-based and only 15-20% transactional, CDK will likely spread out the revenue impact over several quarters and retain a high percentage of its subscription revenues once dealers come back on-line. Based on 2021 estimates, CDK is trading at a forward P/E of 10.6x, which we believe remains attractive.

Purchases and Sales

Given the significant market volatility during the first quarter, the turnover for the Enhanced Equity strategy increased. We added nine positions in Q1 and sold nine positions. The following two positions were called away**: Discover Financial (DFS)** and **Lennar (LEN)**.

For the nine positions that were purchased in the first quarter of 2020, please review the portfolio activity reports from the other Equity Opportunities Group's strategies or contact Sterling Capital for a copy of these reports. The following nine positions were purchased: **Cabot Oil & Gas Corporation (COG)**, **CVS Health (CVS)**, **Lennar (LEN** – added back after having been called away earlier in the quarter**)**, **Premier (PINC)**, **Fiserv (FISV)**, **Bristol-Myers (BMY)**, **NXP Semiconductors (NXPI)**, **PTC (PTC)**, and **Ball Corporation (BLL).**

The following holdings were sold due to thesis changes as the economic impact from the shutdown of the global economy in order to mitigate the health crisis associated with COVID-19 negatively impacted the rationale for owning the following positions: **Occidental Petroleum (OXY)**, **Schlumberger (SLB)**, **Restaurant Brands (QSR)**, **Delta Airlines (DAL)**, **Corning (GLW)**, **Morgan Stanley (MS)**, **Norwegian Cruise Line (NCLH)**, and **Sealed Air (SEE)**

We sold shares of Albemarle (ALB) as the lithium producer experienced prices for its core commodity falling, as near-term supply far exceeded demand and Chinese producers sold at cash costs. ALB curbed investments in new products to help stabilize the market and accelerate its timeline to becoming free-cash-flow positive. We anticipated that earnings estimates for 2020 would likely decline due to lower spot lithium prices and two divestitures.

Conclusion

According to the CBOE Volatility Index (VIX), volatility spiked in the first quarter to all-time highs as concerns rose that the coronavirus mitigation efforts would lead to a deep global recession, yet volatility tends to highlight covered-call strategies like Enhanced Equity. In one sense, the strategy can lower risk by writing out-of-the-money call options, collecting cash from the premium up front. In another, volatility may boost the price for the premiums we receive. Moreover, we participate in the upside of the stocks we buy and see evidence that stock picking adds value. As we consider our current and future investment prospects for the Enhanced Equity portfolio, we believe we can generate above-average returns for our clients while incurring below-average risk.*

As always we thank you for your trust and investment in us.

Sincerely,

Whitney Stewart, CFA®
Executive Director

**All investment strategies and investments involve risk and a client may incur either profits or losses. Past performance is not indicative of future results.*

Performance disclosure: *performance is preliminary and is annualized for periods longer than one year. Net of fees performance returns are presented net of the investment management fees and trading expenses. Pure gross of fees performance returns reflect the deduction of trading costs; a client's return will be reduced by the management fees and other expenses it may incur. Investment management fees are described in Sterling's Form ADV 2A. Performance reflects the reinvestment of interest income and dividends and realized capital gains. The performance presented represents past performance and is no guarantee of future results. Performance is compared to an index, however, the volatility of an index varies greatly and investments cannot be made directly in an index. Market conditions vary from year to year and can result in a decline in market value due to material market or economic conditions. The Performance is considered Supplemental Information to the Composite Disclosure Presentation which is attached.*

The Chartered Financial Analyst® (CFA) *charter is a graduate-level investment credential awarded by the CFA Institute — the largest global association of investment professionals. To earn the CFA charter, candidates must: 1) pass three sequential, six-hour examinations; 2) have at least four years of qualified professional investment experience; 3) join CFA Institute as members; and 4) commit to abide by, and annually reaffirm, their adherence to the CFA Institute Code of Ethics and Standards of Professional Conduct.*

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Sterling Capital Management – Enhanced Equity SMA Composite

December 31, 2003 – December 31, 2019

Description: *Consists of all discretionary separately managed wrap Enhanced Equity portfolios. Sterling's Enhanced Equity portfolios invest primarily in companies held in other Equity Opportunities Group portfolios where call options are written opportunistically to enhance the portfolio's cash flow.*

Year	Total Return "Pure" Gross of Fees	Total Return Net of Fees	No. of Portfolios	Composite Assets End of Period ($MM)	Percent of Firm Assets	Total Firm Assets ($MM)	Composite Dispersion (%)	BXM Index	Composite 3-yr St Dev (%)	Benchmark 3-yr St Dev (%)
2019	28.08	26.20	5	2	0.0	58,191	0.97	15.68	11.18	7.84
2018	-9.23	-10.46	12	6	0.0	56,889	0.75	-4.77	9.96	7.38
2017	12.93	11.30	15	9	0.0	55,908	0.58	13.00	8.50	5.74
2016	13.20	11.17	13	9	0.0	51,603	0.50	7.07	8.79	6.59
2015	-1.90	-3.72	16	9	0.0	51,155	0.49	5.24	8.21	6.43
2014	9.39	7.27	19	11	0.0	47,540	0.30	5.64	8.23	5.90
2013	22.13	19.74	20	11	0.0	45,638	0.50	13.26	11.35	9.44
2012	10.49	8.26	23	10	0.2	4,422	0.69	5.20	13.68	11.60
2011	2.26	0.21	29	12	0.3	3,932	0.77	5.72	15.62	13.69
2010	12.42	10.23	31	15	0.4	3,548	0.60	5.86	20.29	17.22
2009	30.73	28.20	35	21	0.7	2,839	1.03	25.91	18.99	15.88
2008	-32.00	-33.44	48	21	1.1	1,907	1.84	-28.65	16.45	13.42
2007	11.71	9.30	44	22	1.1	2,059	0.75	6.59	6.98	4.69
2006	16.50	13.80	44	22	1.7	1,314	0.63	13.33	6.20	4.11
2005	9.96	7.54	34	14	1.5	904	0.45	4.25		
2004	13.91	11.30	18	7	1.3	522	0.00	8.30		
Annualized Since Inception	8.31	6.22						5.68		

Sterling Capital Management LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Sterling Capital Management LLC has been independently verified for the periods 01/01/01 to 12/31/18. The verification report(s) is/are available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

Notes:

1. Sterling Capital Management LLC (SCM) is a registered investment advisor with the SEC. Registration does not imply a certain level of skill or training. Sterling manages a variety of equity, fixed income and balanced assets. Prior to January 2001, Sterling was a wholly owned subsidiary of United Asset Management (UAM). In January 2001, Sterling Capital Management LLC purchased all the assets and business of Sterling Capital Management Company from UAM to become an employee owned firm. In April 2005, BB&T Corporation purchased a majority equity ownership stake in Sterling Capital Management LLC. In October 2010, the management group of Sterling Capital entered into an agreement with BB&T Corporation that reduced and restructured management's interest in Sterling Capital Management. Additionally, BB&T Asset Management merged into Sterling Capital Management. In January 2013, CHOICE Asset Management firm merged into Sterling Capital Management. "Percent of Firm Assets" and "Total Firm Assets" prior to 2013 are for CHOICE Asset Management. In August 2015, eight new employees joined Sterling Capital management via Stratton Management Company following the close of BB&T's purchase of Susquehanna Bancshares. In December 2019, BB&T Corporation and SunTrust Banks, Inc. Holding Company merged as equals to form Truist Financial Corporation. Sterling Capital Management LLC is a wholly owned subsidiary of Truist Financial Corporation.
2. George F. Shipp, CFA, has managed the portfolio since inception. No alterations of composites, as presented herein, have occurred due to changes in personnel or other reasons at any time.
3. Inception date of composite: December 31, 2003. Creation date: December 31, 2003. The appropriate index is the CBOE Buy/Write Index (ticker symbol BXM) that is designed to show the performance of a basket of S&P 500 stocks with calls written monthly at the money. It represents the universe of stocks from which covered call managers typically select. Total return includes price appreciation/depreciation and income as a percent of the original investment. A complete list of all of SCM's composites and their descriptions is available upon request. Policies for valuing portfolios, calculating performance and preparing compliant presentations are available upon request.
4. Performance reflects reinvested interest income and dividends and realized and unrealized capital gains and losses. All portfolios are valued monthly as of calendar month-end and utilize trade-date and accrued income accounting. Valuations and performance are reported in US dollars. Portfolio returns are calculated monthly using the Modified Dietz method. Portfolios are revalued for cash flows greater than 10%. Composite returns are calculated by weighting the individual portfolio returns using beginning of period market value plus weighted cash flows. Periodic time weighted returns are geometrically linked. Returns are not calculated net of non-reclaimable withholding taxes due to immaterial dollar amounts.
5. "Pure" gross of fees returns do not reflect the deduction of any fees including trading costs. The net of fee return reflects the actual SMA fee of the individual account. The SMA fee includes all charges for trading costs, portfolio management, custody and other administrative fees. Sterling's actual management fees are 32 basis points annually.
6. The annual composite dispersion presented is measured by an asset-weighted standard deviation calculation method of all portfolios in the composite for the entire year. It is not meaningful when there are less than six portfolios in the composite for the entire year. The three year annualized standard deviation measures the variability of the composite and benchmark returns over the preceding 36 month period. It is not required to be presented for annual periods prior to 2011 or when a full three years of composite performance is not yet available.
7. The performance presented represents past performance and is no guarantee of future results. Stock market conditions vary from year to year and can result in a decline in market value due to material market or economic conditions.