



“Flexibility is the key to stability.” - John Wooden

The Sterling Capital Special Opportunities strategy is designed to be a “core” or “all-seasons” portfolio, with a primary goal of generating long-term capital appreciation. Noting that our industry often classifies investments with either a “growth” or “value” label, we instead argue that value without growth represents a wasting asset, and growth without regard to the price is merely speculation. We strongly believe in building a well-diversified portfolio with constituents that boast both growth and value characteristics. We seek above average growth of capital, but endeavor to mitigate downside risks by using time tested valuation tools and profitability (“quality”) parameters.

Academic literature and our own experience have demonstrated that the so-called growth and value styles, as well as small- and large-capitalization companies, move into and out of investment favor, much as our underlying economy moves through various phases of expansion and retrenchment. Sustained periods of out- or under-performance can lead to unproductive investor outcomes via switching. By blending the characteristics, we hope to offer our clients a more consistent return profile, while also allowing us the flexibility to take advantage of occasional perceived extremes in sentiment.

Consistent with our endeavor to generate above average returns with below average risk, when compared to the overall equity market, we must “dare to be different” from our benchmark. In industry parlance, our portfolio demonstrates high “active share,” meaning our philosophy offers the statistical opportunity to outperform popular averages. By constructing portfolios with 30-35 carefully selected securities, we believe we can achieve 95% of the diversification of a 500-stock portfolio – while eliminating expensive, poorly-financed, or strategically vulnerable companies from our holdings.

Performance Summary and Review

The Special Opportunities portfolio gained 20.3% (gross of fees) and 20.0% (net of fees) for the quarter, narrowly trailing the Russell 3000®’s 22.0% increase. Year-to-date, the portfolio returned -10.1% (gross of fees) and -10.7% (net of fees), trailing the Russell 3000®’s -3.5% return. The world moved from the “Great Lockdown” to re-opening, with businesses and consumers supported by extensive fiscal and central bank stimulus. Investors’ fear quickly switched to fear of missing out. Equity indices discounted a recovery posthaste, delivering the best quarterly return in 22 years and only the third 20%+ quarterly return since 1938. Still, the median Russell 3000® company remains -17.9% underwater year-to-date.

As is typical during a sharp recovery, lower quality led. Companies with the lowest ROE’s in the Russell 1000® gained 29%, unprofitable companies rose 36% and the most expensive returned 30%. The year-to-date spread between the most expensive and cheapest constituents is now 38%. Technology companies entering the year with an enterprise-to-sales ratio greater than 10x have returned an average of 57% year-to-date.

2Q20 Contributors and Detractors

Top Contributors	GICS Sector	Contrib. to Return
Hologic	Health Care	1.81
NXP Semiconductors	Info Technology	1.45
Lennar	Consumer Dis.	1.42
Danaher	Health Care	1.29
Aptiv	Consumer Dis.	1.27

Top Detractors	GICS Sector	Contrib. to Return
Check Point Software	Info Technology	0.15
Fiserv	Info Technology	0.11
Charles Schwab	Financials	0.08
F5 Networks	Info Technology	0.03
Ryman Hospitality Properties	Real Estate	0.00

Source: FactSet

Top contributors:

- **Hologic**, a leader in women’s health, beat estimates and raised guidance owing to its COVID-19 test, Aptima. One million tests are being delivered per week and capacity is expected to increase later in the summer by 50% or more. At an average price in the low \$20s per test and a cost of \$1-2, Aptima could generate more than \$1 billion in revenues, a third of last year’s total, and as much as \$2 in EPS, more than 80% of last year’s profits. More importantly, Panther (the diagnostic machines that process the tests) placements are increasing from 20 per month to 40 per month, providing a longer-term revenue stream of \$250,000 per year in consumables, on average. This should improve the growth profile and increase the diagnostic mix of revenues to 40%-45%, possibly warranting a higher valuation.



- **NXP Semiconductor** managed channel inventories well during COVID-19 related disruptions. Management noted green shoots in China in late April and didn't experience any supply chain related issues. Beyond 2020, we see NXP benefiting from 5G, mobility, active safety, electric vehicles and IoT in the industrial sector.
- **Lennar**, a leading homebuilder, revealed a snap back in orders in May (+7%) and June (+20%). Management noted early signs confirming speculation in the market that COVID-19 induced trends, such as moving from urban to suburban, buyers desiring offices, etc., are indeed playing out. Low interest rates and record low existing home inventories create a strong demand and pricing backdrop, while scale and increased use of technologies support higher margins.
- **Danaher** delivered another quarter of mid-single digit core growth, with a COVID-19 kicker. The Integrated DNA Technologies (IDT) division sent over 30 million tests by early May, Beckman Coulter was developing assays to identify antibodies, Pall and Cytivia (old GE Biopharma) were working with the majority of the companies developing vaccines (providing filtration and resins) and Cepheid developed a test with results available in 45 minutes on its installed base of 23,000 machines. Similar to Hologic, Cepheid should benefit from increased placements beyond COVID-19 testing.
- **Aptiv**, an auto supplier, delivered 13% revenue growth over market during the first quarter (based on light vehicle volumes in its geographies), supported by increasing adoption of active safety technologies and electric vehicles. In mid-June, CFO Joe Massaro reiterated Aptiv's 2023 plan to more than double active safety revenues to \$2.5 billion and more than triple high voltage revenues relative to electric vehicles, to more than \$1 billion.

Top detractors:

- **Ryman** re-opened entertainment venues in May and four of its five hotels in June. Management noted, "Initial spending and demand has been encouraging and indicates pent-up demand." Ryman is helping Nashville artists who had to cancel tours book events at the Ryman Auditorium later this year. While the shutdown will severely impact Ryman's 2020 financial results, we believe the company's conservatively managed balance sheet – \$828 million of available liquidity, enough to cover 22 months of operations – coupled with the decision to retain 80% of its salesforce throughout the pandemic will lead to an even stronger market position when the virus is contained and the economy recovers. Room nights on the books for 2021, at 1.6 million, are up 1.2% versus the same point last year. We don't know if these events will be allowed to take place, but we do know associations are eager to hold events that help them raise funds.
- **F5 Networks** was added late in the quarter and therefore didn't have much time to impact performance. Our purchase rationale is detailed in the *Portfolio Changes* section.
- **Schwab** slumped with interest rates, even as the firm grew client assets at a 5.6% annualized pace in May and closed the acquisition of USAA's Brokerage and Wealth operations, adding \$80 billion of assets and 1.1 million brokerage accounts. The pending acquisition of TD Ameritrade received anti-trust approval and should close in the second half of the year. The level of rates is out of management's control, but they are executing on gathering assets and achieving scale, as total client assets topped \$4 trillion.
- **Fiserv**, provider of bank processing software and electronic payments, didn't participate in the 2Q rally even as it posted enviable results. Internal revenue growth was 4%, against its most difficult comparison of the year, and EPS increased 16%. Clover's "order ahead" capabilities were in high demand and are already used by 1,800 restaurants. Clover's shipped devices rose 25% and gross payment volume increased 29%. Management raised cost synergy targets related to its 2019 purchase of First Data to 12% of its cost base. Additionally, synergies are being achieved quicker than anticipated, with 2020 savings raised from \$200 million to \$500 million and a year-end exit rate of \$700 million. Management wouldn't provide explicit guidance, but conveyed confidence in delivering its 35th consecutive year of double-digit EPS growth.
- **Check Point Software**, a leader in cybersecurity, "only" gained 7% during the quarter after holding up relatively well during the carnage at the beginning of the year. Check Point's business has proved resilient as well, with earnings expected to be up each quarter this year.



Portfolio Changes

We added two holdings and did not sell any, increasing exposure to secular growth areas such as work-from-home, cybersecurity, migration to the cloud and sustainability.

We added **F5 Networks**, the leading provider of application delivery controllers (ADCs), but importantly, growth drivers have shifted from hardware in the data center to a software play on multi-cloud application growth. F5 has added open source application delivery technologies and with the acquisition of Shape, now has a more robust platform to deliver and secure applications in the cloud that can be accessed by users anywhere, anytime. As the world adapted to COVID-19, working remotely became a necessity that in many cases resulted in increased productivity. We believe a shift toward remote capabilities was inevitable, but the virus likely accelerated the timeline to adoption. IDC estimates there were 700 million application instances in 2018, which will grow at a 40% CAGR to 3.7 billion by 2023. F5 not only provides technology to develop new applications, but also provides application layer security, application infrastructure security and trusted access. High profile customers include Adobe, Cloudflare and Capital One. The recently announced partnership with Amazon's cloud service, AWS, provides additional validation of the quality of F5's offerings, while also opening doors to new relationships. Trading at an 8% free cash flow yield, F5 is being valued like a hardware company. We believe the transition to more software and subscription services will result in steadier, faster revenue growth that should drive a rerating of the stock.

Anti-Fraud Extends F5's Application Security Portfolio



Source: F5 Networks

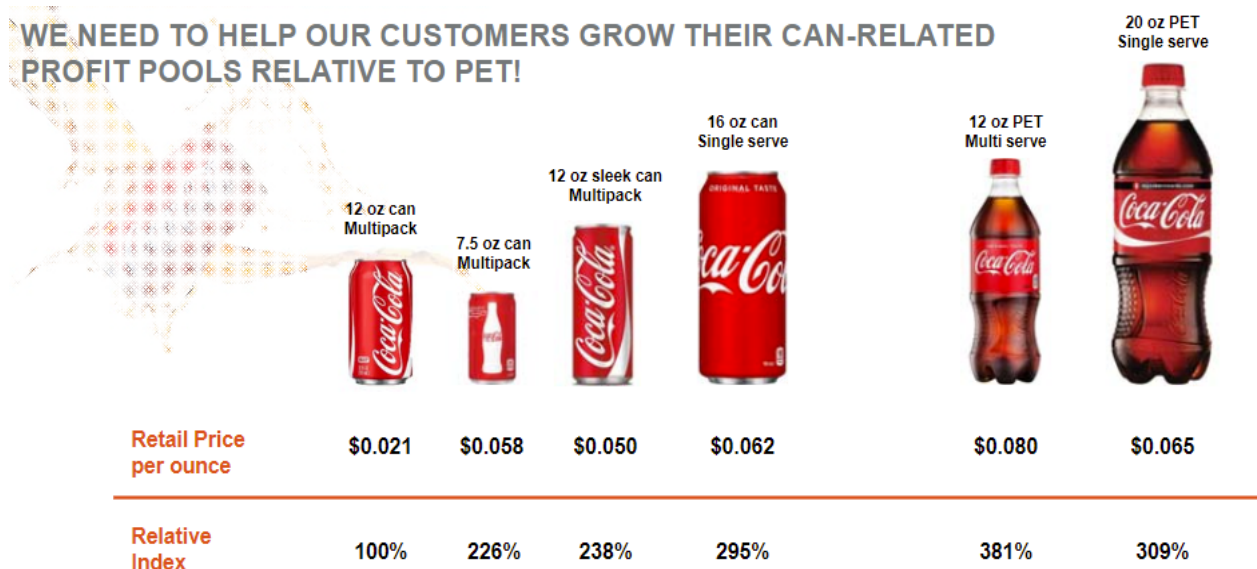
We also added **Ball Corporation**. Ball is the leading manufacturer of aluminum beverage cans domestically (45% share) and globally, with output exceeding 100 billion cans per year. We agree with management that demand for aluminum cans will accelerate due to sustainability trends, from 2-3% per year to a range of 4-6%. The transition is already underway, with consumers shifting preferences from plastic and glass substrates to more environmentally friendly, infinitely recyclable aluminum cans. In the U.S., the average aluminum can has a recycled content of 73% and when a can is produced from recyclable material, it saves 95% of the energy used and greenhouse gas emissions produced versus using virgin material. Plastic still accounts for 70% of total beverage volumes and management estimates a 1% share gain from plastic carbonated soft drinks would add five billion cans per year, while a 1% shift from plastic water would add 13.2 billion cans per year.



Source: Ball Corp



At the same time, beverage producers' appetite for higher margin specialty can sizes is expanding. Specialty cans offer producers the dual benefit of providing greater product differentiation and increasing per-ounce profitability. Ball's leadership in the category, where it derives close to 45% of beverage can revenues, twice the industry's mix, has contributed ~350 basis points of EBITDA margin gains over the past five years.



MAKING PROGRESS...AND STILL MORE TO DO!

Source: Ball Corp

Ball's domestic growth is limited by its own capacity, as North American demand exceeds supply and all of its product is spoken for. Ball has new capacity coming online later this year and into 2021, while also benefiting from a strong pricing backdrop. Sustainable mid-single digit volume growth, mix benefits, pricing power and operating leverage should drive double-digit profit growth for the foreseeable future. Factoring in management's record of astute capital allocation and guidance for medium-term EPS growth of "at least 10-15%" appears readily achievable.

Conclusion

While the sharp recovery in equity markets indicates a sanguine outlook as the economy re-opens, management teams appear more despondent, withdrawing guidance, bolstering balance sheets, pausing stock repurchases and bracing for further fallout. Corporate debt issuance in the first five months topped \$1 trillion, with March setting a new monthly record that was broken in April. Buybacks fell -44% year-over-year in 2Q and the final week of the quarter saw the lowest level of buying in eight years. Insider purchases have eased from an extreme buy signal back to neutral territory. Individual investors also appear more circumspect, with the latest AAII survey showing 14% more bears than bulls. But, markets often climb a "wall of worry" and history tells us double-digit equity returns follow when bears have outweighed bulls by similar amounts. The worst economic data releases may be in the rearview mirror – ISM Manufacturing and new orders recovered into expansion territory in June. The Fed's accommodation appears limitless and record low interest rates result in equities as among the only alternatives. The bottom line is there's a lot to digest, sundry conflicting data points and the widest range of potential near-term outcomes we can recall. Additionally, the election in November could result in a dramatic change in tax rates.

Despite the elevated level of uncertainty, we believe the portfolio is positioned to perform well in most economic environments. We didn't see a global pandemic coming, but we've taken action to reduce exposure to travel-related businesses that face a lengthier recovery in almost any scenario. We've added exposure to companies with technologies enabling electronic payments, cybersecurity, the shift of applications to the cloud and sustainability. Corporate and consumer adoption and spending should increase in these areas whether we experience a second wave, a V-shaped recovery or something in-between. In many cases, adoption of digital capabilities has been pulled forward as companies recognize their importance.



The resiliency of our new holdings is evident in flattish earnings estimates in 2020, on average, while our exited positions' earnings are forecast to contract more than -70%. Comparing 2021 estimates to 2019, the average EPS growth for our new holdings is 24% versus a decline of -71% for our sales. The average new holding generates an ROE of 19% compared to just 1% for our exits, sports EBITDA margins that are more than double our exited positions and operates with lower leverage. As shown in the table below, the median holding is expected to deliver faster, more consistent earnings growth, trades at a discount, is more profitable and is managed with a more conservative balance sheet.

Pillar Metrics: Growth, Valuation, Profitability & Balance Sheet Strength

	Growth/Stability				Valuation			Profitability		Balance Sheet	
	20y EPS Growth	21y EPS Growth	'16-'21 EPS CAGR	'19-'21 EPS Gr	21y EV/ P/E	21y EV EBITDA	21y EV FCF Yld	ROE	EBITDA Mgn	Interest Coverage	Leverage
SO Median *	-6%	14%	10%	10%	17.6	12.2	4.4%	15.9	26.3	6.3	2.3
R3000 Median	-18%	9%	3%	-9%	21.3	12.9	3.6%	7.1	13.6	2.7	2.5
vs Benchmark	12%	5%	7%	19%	-17%	-6%	23%	125%	93%	131%	-9%

*Representative account. Source: Bloomberg

As always, we thank you for your interest in the Sterling portfolios.

Josh Haggerty, CFA®
Associate Portfolio Manager

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 do not reflect the deduction of any fees including 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.

Russell 3000®: The Russell 3000® Index measures the performance of the largest 3,000 US companies representing approximately 98% of the investable US equity market.

Russell 1000®: The Russell 1000® Index, a subset of the Russell 3000 Index, measures the performance of the largest 1,000 U.S. companies, representing over 90% of the investable U.S. market.

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 – Special Opportunities SMA Composite

December 31, 2000 – December 31, 2019

Description: Consists of all discretionary separately managed wrap Special Opportunities portfolios. Sterling's Special Opportunities equity portfolios invest primarily in companies with the best perceived combination of underlying growth potential and attractive valuation in a concentrated portfolio that has the flexibility to shift among styles.

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 (%)	Russell 3000 Index	Composite 3-yr St Dev (%)	Benchmark 3-yr St Dev (%)
2019	27.22	25.74	4	525	0.9	58,191	Not Meaningful	31.02	12.31	12.21
2018	-3.32	-4.46	4	453	0.8	56,889	Not Meaningful	-5.24	10.99	11.18
2017	20.55	19.08	4	493	0.9	55,908	Not Meaningful	21.13	9.85	10.09
2016	5.72	4.31	4	721	1.4	51,603	Not Meaningful	12.74	10.35	10.88
2015	9.39	8.00	4	901	1.8	51,155	Not Meaningful	0.48	9.67	10.58
2014	15.93	14.23	4	927	1.9	47,540	Not Meaningful	12.56	9.33	9.29
2013	26.61	24.72	4	850	1.9	45,638	Not Meaningful	33.55	13.49	12.71
2012	15.45	13.68	4	718	16.2	4,422	Not Meaningful	16.42	13.75	15.95
2011	-2.72	-4.18	3	776	19.7	3,932	Not Meaningful	1.03	17.35	19.62
2010	12.79	11.08	3	868	24.5	3,548	Not Meaningful	16.93	22.62	22.94
2009	39.65	37.53	2	752	26.5	2,839	Not Meaningful	28.94	21.26	20.61
2008	-32.07	-33.08	2	507	26.6	1,907	Not Meaningful	-37.31	19.08	16.02
2007	16.24	14.60	1	552	26.8	2,059	Not Meaningful	5.14	8.80	8.25
2006	23.07	21.29	1	346	26.3	1,314	Not Meaningful	15.72	8.62	7.62
2005	4.67	3.11	1	261	28.9	904	Not Meaningful	6.12	10.45	9.63
2004	29.90	27.85	1	155	29.7	522	Not Meaningful	11.95	14.87	15.05
2003	45.35	42.97	1	55	34.8	158	Not Meaningful	31.06	17.20	18.37
2002	-16.17	-17.58	1	27	52.9	51	Not Meaningful	-21.54		
2001	10.65	9.18	1	15	62.5	24	Not Meaningful	-11.46		
Annualized Since Inception	11.53	9.91						7.17		

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, 2000. Creation date: December 31, 2000. The appropriate index is the Russell 3000 Index which measures the performance of the largest 3,000 US companies, representing approximately 98% of the investable US market. It represents the universe of stocks from which all-cap managers typically select. The index is reconstituted annually. 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. Portfolios utilize trade-date accounting. Valuations and performance are reported in US dollars. Composite returns are calculated monthly by weighting the aggregate SMA/Wrap sponsor returns using beginning of period market values. Periodic time weighted returns are geometrically linked. Returns are not calculated net of non-reclaimable withholding taxes due to immaterial dollar amounts.
5. The net of fee return reflects the actual SMA fee of the individual portfolios in each platform except for one platform where the maximum fee is deducted from the gross return. The SMA fee includes all charges for trading costs, portfolio management, custody and other administrative fees. The actual fee may vary by size and type of portfolio. Sterling's actual management fees are 50 basis points annually or less.
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. The dispersion is not meaningful because less than six portfolios are in the composite. 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.