COMMENTARY
Special Opportunities SMA | 4th Quarter 2019

"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 boasts 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 – importantly while eliminating expensive, poorly-financed, or strategically vulnerable companies from our holdings.

Performance

The Special Opportunities portfolio returned 8.3% (before fees) and 8.0% (after fees) during the fourth quarter of 2019 versus the Russell 3000 index's return of 9.1%. For full-year 2019, the Special Opportunities strategy returned 27.2% (before fees) and 25.8% (after fees) compared to the Russell 3000 index's return of 31.0%.

Winners & Losers

Eleven stocks enjoyed double-digit percentage gains in the quarter, while none fell more than 10%. The largest intra-quarter movers were:

United Health (+36%) was the biggest gainer, helped in-part by improving sentiment around "Medicare for All" proposals offered by Democratic presidential candidates that it increasingly appears may expand the market for private health insurers versus contract it. In addition, in mid-December, Congress voted to permanently remove the "Health Insurance Fee" (HIF) – a tax levied against health insurers as a funding mechanism for the Affordable Care Act. In our view, removing the tax should help 2020 health insurer earnings, including United.

Bristol Myers (+28%) was helped, in our view, by the closure of the Celgene merger and the sale of the combined company's Otezla drug to Amgen for more than $13 billion in late November. Recall that in addition to perceived strategic benefits, the merger of the two companies is expected to generate at least $2.5 billion in synergies by 2022 on an annual revenue base expected to be around $42.3 billion, according to Morgan Stanley. In addition, Bristol shared positive data with regard to a next-generation blood cancer treatment in development at the annual American Society of Hematology conference held in early December.

Discovery (+24%) benefitted from a strong third quarter earnings result and future outlook, as the company overcame cable subscriber and ratings headwinds in the United States with stronger-than-expected international revenue and overall margin strength. In addition, the company reached the low end of its financial leverage targets at just over 3.0x net debt to adjusted OIBDA and therefore initiated a sizable $1.0 billion buyback. We note increasing optimism over the 2020 outlook given the Tokyo Olympics, as well as over the possibility of the company leveraging its content directly to the consumer.

HCA's (+23%) initial 2020 outlook positively surprised investors. More specifically, management anticipates EBITDA growth slightly above 6% this year, supported by a continuation of solid operating trends and an attractive environment for acquisitions; consensus estimates called for growth closer to 5%. Also, like United Health's stock, we believe HCA benefitted from positive sentiment as Democratic presidential candidates offered more moderate healthcare policy proposals than previously expected.

As Medicare reimbursement is generally lower than the rates HCA receives from commercial insurers, we believe it was a net positive that (at least for now) a "hardline" Medicare For All policy seems less probable.

NXP Semiconductor (+17%) continued its ascent in 2019, driven by positive company-specific drivers relative to the backdrop for semiconductors that has been challenged by the China trade dispute. More specific, NXP's single-digit percentage revenue decline this year has outperformed a mid-teens decline for the semiconductor industry; this outperformance has been driven by chip designs at automakers for the radar systems that that enable key safety features and a specific chip design win that enables mobile device connectivity at China handset giant, Huawei. In 2020, we look forward to the possibility of NXP's earnings growth accelerating as stabilization of global trade dynamics provide a more hospitable environment for revenue growth, as company-specific margin drivers are realized, and as share repurchases enhance underlying EPS performance.

Verisk Analytics (-5%) reported a fine quarter but the stock's more than 30% year-to-date return going into its September-quarter earnings results made for a high sentiment bar for the company to hurdle. Organic growth of 7.6% in the quarter marked the fourth consecutive quarter of growth acceleration, but margins were flattish over the same quarter last year. Moreover, trends in the Financial Service segment (the smallest of Verisk's three segments at 7% of revenue) continued to lag, and an unfavorable court ruling in one of the company's Insurance business lines (Geomni) will cost the company 1% of total revenue on a go-forward basis.

Akamai Technologies (-5%) also underperformed, as management guided the fourth quarter of 2019 in-line with expectations after a 50% rise from the beginning of the year through Q3. Per B. Riley, "while 4Q is typically the strongest quarter of the year driven by e-commerce and media, management was clear that it is also the most unpredictable." It is possible that the guide could be conservative considering the momentum of Akamai's cybersecurity business and recent launches of major over-the-top (OTT) services, Apple TV+ and Disney+, which have the potential to drive considerable traffic over Akamai's content delivery network (CDN).

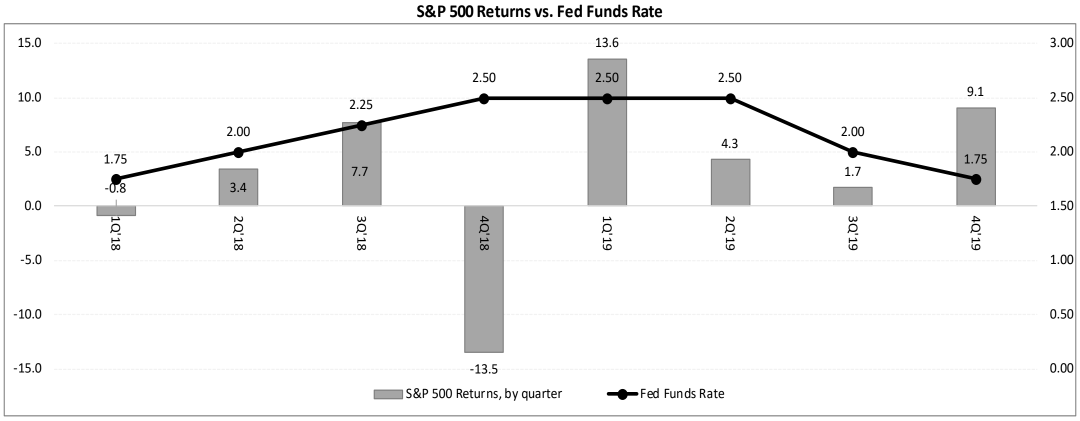
Other laggards included **Cisco (-2%), Intuit (-1%),** and **Lennar (flattish)**. Trade-related uncertainty became a reality last quarter according to CEO Chuck Robbins, driving broad weakness – the company does not believe this weakness was company-specific. Intuit's and Lennar's stock both took a breather in the fourth quarter, although, in our view, this was more a function of stronger returns earlier in the year, as Intuit appreciated 34% and Lennar appreciated 43%, respectively, in 2019.

Portfolio Changes

There were no new purchases or sales in the strategy during the quarter.

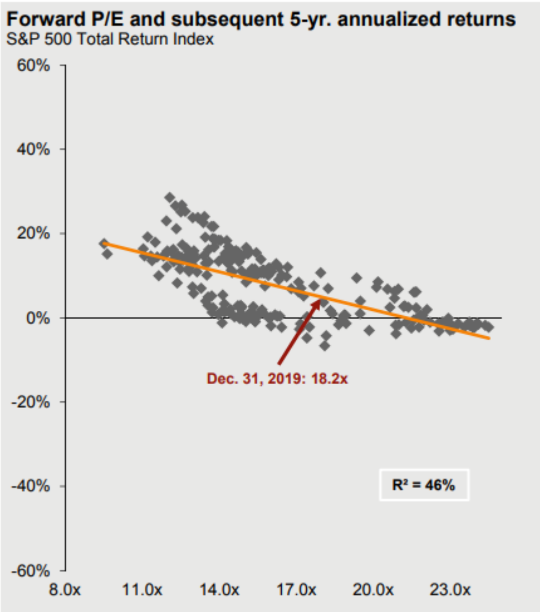
Conclusion

Stocks ended the year strong with a fourth quarter total return of 9.1%, capping off a 31.5% total return for the S&P 500 in 2019. Returns, in the quarter just ended, were the second strongest quarter over the past 24 trailing quarters, as market sentiment shifted from concern regarding trade tensions in late 2018 towards optimism, as the Federal Reserve embarked on a more accommodative monetary policy beginning in the second quarter.



Source: Standard & Poor's, Federal Reserve

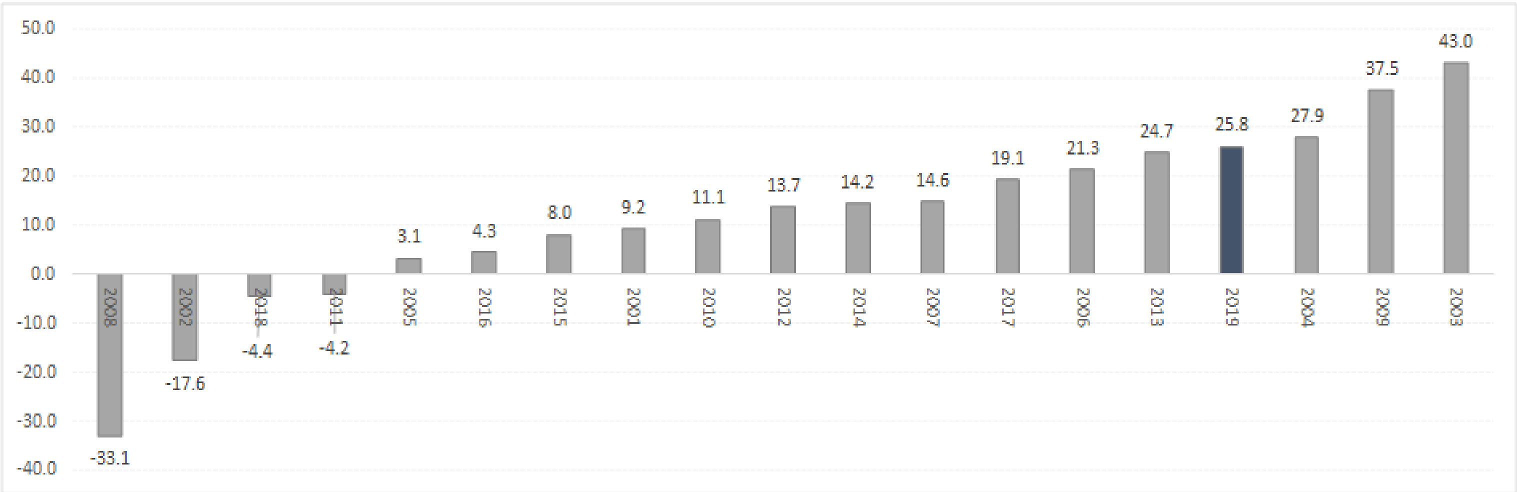
Decoupling the year between earnings growth and multiple expansion, 2019 was notably weighted towards the latter. With fourth quarter results still to be reported, S&P 500 earnings are forecasted to grow only 1% given the economic impact of trade tensions with China, pockets of cost pressure in areas such as transportation expenses, currency headwinds, and idiosyncratic developments such as Boeing's challenges with the 737 Max. As of year-end, the S&P 500 multiple stood at 18 times – approximately two turns over its 25-year average of 16 times. Still, as highlighted in the figure below, this valuation level has largely been associated with positive returns over a prospective five-year period.



Source: J.P. Morgan

Relating this to the Special Opportunities strategy, our 2019 results stand out by historical standards – last year represented our fourth best year (net of fees) in the 19 years since our SMA inception. And while results lagged our benchmark, we note history has shown that relative to the market, we tend to outperform the market in years of more medium-sized returns (or less) in the market versus the positive outlier years. More specifically, since 2001, the Special Opportunities SMA has outperformed the Russell 3000 index in years of a 15% return or less eight out of 11 times, whereas we've batted three for eight in years in which the market returns 15% or more. Most importantly, these variances have worked out over time in our favor; since inception, the Special Opportunities SMA has posted a compounded annualized average return (net of fees) of 9.9%, or sizably above the Russell 3000 index's return of 7.2% over this same time period.

Special Opportunities SMA Annual Returns, Net of Fees



Source: Sterling Capital Management

As alluded in the introduction above, all of this ties into an investment process that we believe is evidence-based. Recall that to maximize our chances of outperforming the market, we seek to assemble a portfolio of companies with better-than-average earnings growth and return on equity, with below-average financial leverage and price-to-earnings ratio. According to Ned Davis Research, each of these attributes have a history of outperforming the market over the long term. And as the table below shows, this is exactly how the portfolio was positioned as of year-end.

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

	19y Gr	20y Gr	'15-'20 EPS CAGR	19y P/E	20y P/E	ROE	Int Cov
SO Median *	9%	9%	13%	16.6	15.4	15.6	7.6
R3000 Median	4%	6%	7%	22.7	20.3	8.7	3.2

**Representative account. Source: Bloomberg*

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

Jeremy Lopez, CFA®
Director

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. 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 – Special Opportunities SMA Composite

December 31, 2000 – December 31, 2018

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	Composite 3-yr St Dev (%)	Benchmark 3-yr St Dev (%)
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	9.59	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	15.75	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	28.34	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	10.71	9.10						5.98		

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 12/31/17. 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. There were no changes in personnel. In April 2005, BB&T Corporation purchased a majority equity ownership stake in Sterling Capital Management LLC. There were no changes in personnel. 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. There were no material changes in personnel. In January 2013, CHOICE Asset Management firm merged into Sterling Capital Management. There were no changes in personnel. "Percent of Firm Assets" and "Total Firm Assets" prior to 2013 are for CHOICE Asset Management. In August 2015, 8 new employees joined Sterling Capital management via Stratton Management Company following the close of BB&T's purchase of Susquehanna Bancshares. There were no changes to personnel.
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. 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 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. "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 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.