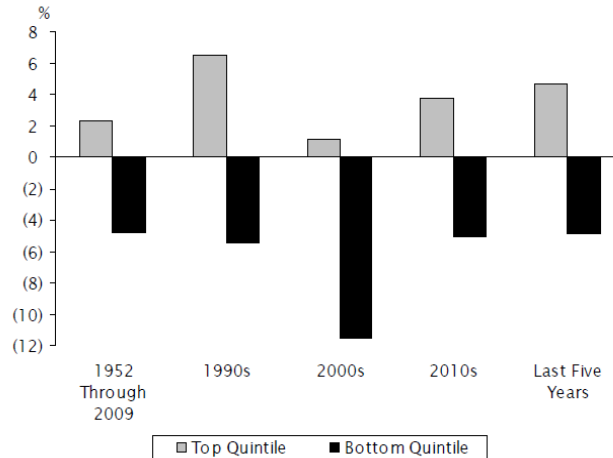




“No Margin, No Mission”

- Credited to Sister Irene Kraus, the first president of the Daughters of Charity National Health System

**Exhibit 1: Large-Capitalization Stocks
Relative Returns to the Top and Bottom Quintiles
of Free Cash Flow Margins
Monthly Data Compounded to Annual Periods
1952 Through Mid-February 2020**



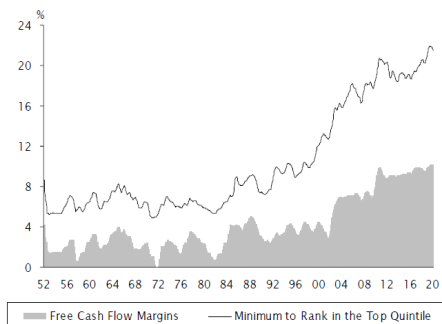
Source: Empirical Research Partners Analysis.

According to Empirical Research, free cash flow margins have been the best performing characteristic in the U.S. large cap market over the past one, three, five and ten year periods. While the valuation metric of free cash flow yield used to provide more alpha generation than free cash flow margin, margins became more important five years ago, as concerns over global growth saw investors finding value in incremental growth rather than cheaper valuations. The chart above shows companies that generate top ranked free cash flow margins have a history of outperforming, but have done so to a greater degree in the past five years.

As a result, the top 10% of high free cash flow margin stocks trade on average at a 12% premium to the S&P 500. The final wrinkle on this market dynamic is that high free cash flow margins have recently been coupled with fast growing top-line growth in the technology sector, resulting in information technology stocks leading the market, despite premium valuations. Brick and mortar value stocks have been left in the dust as technology stocks offer not only attractive revenue growth and operating margins, but also declining capital intensity as they have matured. The New Economy story

of the 1990’s remains a key component in these trends, as capital intensity is roughly half that of the 1950’s based on Empirical’s work. As public companies drive efficiencies to attract capital, the bar to be in the top 10% of stocks with high cash flow margins has continued to move higher. In the chart below, margins that made it possible for a company to be included in the top 10% club in the early 1980’s of around 6-8%, now need to be in the 20% range.

**Exhibit 2: Large-Capitalization Core Stocks*
Free Cash Flow Margins and the Minimum
to Rank in the Top Quintile
1952 Through Mid-February 2020**

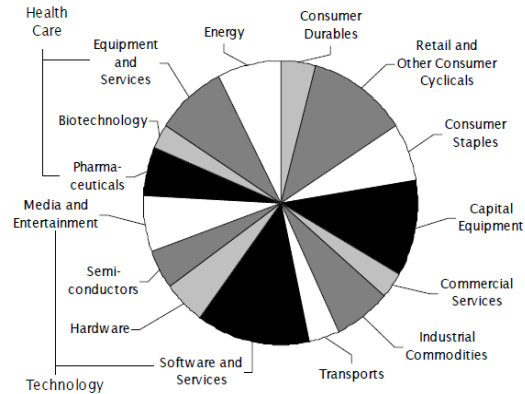


Source: Empirical Research Partners Analysis.

*Excludes financials, REITs, utilities, energy and industrial commodities; data smoothed on a trailing six-month basis.



**Exhibit 7: Large-Capitalization Stocks
Top Quintile of Free Cash Flow Margins
Distribution of Stocks by Sector
As of Mid-February 2020**



Source: Empirical Research Partners Analysis.

One question we receive from institutional due diligence teams is why our strategies tend to be overweight technology and healthcare relative to the benchmark. One characteristic we point to is the quality of these businesses, and the Empirical work provides quantitative support for these assessments and the ability for these stocks to drive outperformance over time.

We highlight in the chart above that technology and healthcare sectors account for almost half of the high margin large cap companies. While we vigorously debate the role of stock based compensation in some of

these calculations, we do focus on finding companies with improving trends in free cash flow and earnings that we view as improving fundamentals. While we focus on bottom up stock selection, Empirical continues to forecast that premiums will be awarded to companies that can generate strong free cash flow and earnings growth on modest top line growth in a slow growth global economy. In the end, it appears quality businesses also make quality investments.

As always, thank you for your interest and trust managing your investments.

Charles J. Wittmann, CFA®, Executive Director, joined Sterling Capital Management in 2014 and has investment experience since 1995. Chip is an equity portfolio manager. Prior to joining Sterling, he worked for Thompson Siegel & Walmsley as a portfolio manager and (generalist) analyst. Prior to TS&W, he was a founding portfolio manager and analyst with Shockoe Capital, an equity long/short hedge fund. Chip received his B.A. in Economics from Davidson College and his M.B.A. from Duke University's Fuqua School of Business. He holds the Chartered Financial Analyst® designation.



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