Long/Short Equity Fund | 4th Quarter 2016

Fund Performance 12.31.2016	QTR	YTD	1 Year	3 Year	Since Inception
A Shares with 5.75% Sales Charge	-3.17%	1.38%	1.38%	-4.52%	-4.09%
A Shares without Sales Charge	2.79%	7.53%	7.53%	-2.60%	-2.21%
Institutional Shares	2.88%	7.98%	7.98%	-2.32%	-1.93%
HFRX Equity Hedge Index	0.79%	0.10%	0.10%	-0.28%	0.37%
S&P 500 Index	3.82%	11.96%	11.96%	8.87%	10.20%
Lipper Alternative Long/Short Equity Median	1.66%	3.36%	3.36%	1.77%	--

Past performance does not guarantee future results. The performance data quoted represents past performance and current returns may be lower or higher. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. To obtain performance information current to the most recent month end and information on other share classes, please visit www.sterlingcapitalfunds.com. The Expense Ration for the A Shares and Institutional Shares are 3.16% and 3.36%, consecutively.

During the fourth quarter, the Sterling Capital Long/Short Equity Fund was up 2.88% for the Inst'l Shares (2.79% and -3.17% for A Shares with and without sales charge, consecutively). The HFRX Equity Hedge Index, the fund's primary benchmark, was up 0.79% and the S&P 500 (Total Return) was up 3.82% for the quarter. Once again, the fund captured well in excess of what its daily average net exposure would have indicated. While the post-election rally in financials and energy shares contributed to returns during the quarter, we feel that the environment for idiosyncratic ideas, of which we own many, has improved markedly. While the long side slightly outperformed the market, the short side outperformed quite substantially if you take the inverse of the market's return as a proxy for outperformance.

While the fund's performance in October was disappointing due to our exposure to small cap technology and healthcare names, November and December was a particularly strong period. Post-election, we witnessed a strong move in our energy and financials sleeves. For the quarter, our long exposure to financials, short exposure to health care, and long exposure to energy contributed most significantly to results. Long exposure to health care, short exposure to financials, and long exposure to consumer staples detracted from results in the quarter.

The fourth quarter was marked by strength in our financials and energy sleeve and weakness throughout the rest of the portfolio. Below are some highlights from the quarter:

- The fund's quarterly performance, up 2.88% (Inst'l Shares), was well above not only its benchmark, the HFRX Equity Hedge Index, but also the Morningstar Long/Short Equity Category. On an equally weighted basis this peer group was up 0.69% in Q4.
- During each month of the quarter, Gator Capital, our long/short financials manager contributed the most to the fund's performance.
- The financials sleeve far outpaced its long only benchmark, the Financial Select Sector SPDR Fund. Given the sleeve's roughly 34% net exposure throughout the quarter, this performance is especially impressive.

During the quarter OPEC announced a deal to cut oil production, we saw a sharp back up in interest rates, an even sharper rally in financials shares and the election of a new President of the United States. To varying degrees, each of these events was not foreseen by the market. When one also recalls that the BREXIT vote results were also not foreseen, it is easy to feel humbled by 2016. The year provided a nice analog to one of our key portfolio management tenets, "do not attempt to predict sector performance because predicting things is hard." Predicting most things is hard. The performance of our financials sleeve in just the fourth quarter would have been a good result for a three year period, let alone a three month period, for example. This could never have been predicted.

We continue to not tactically weight our sector focused long/short managers. By using cash flows into and out of the fund to constantly keep our managers' allocations in line with our strategic weightings, we avoid being without exposure to a sector when we most need it. We avoid attempting to predict or the appearance of it. We are happy to not be in the prediction game because you just never know when opportunity presents itself.

Discipline, Patience & Perseverance (Part 2)

In last quarter's commentary we wrote about Gator Capital, our long/short financials manager, as an excellent example of what we most value in a long/short equity manager: discipline, patience and perseverance. Fast forward a few months and we can provide solid evidence that this worked. Below is an excerpt from last quarter's update:

> *The core holdings in our financials sleeve have remained relatively unchanged over the last couple of years. Sentiment around banks, asset managers and non-bank lenders has been lackluster at best. These names have languished against a narrative of low interest rates, a much increased regulatory regime and the looming contagion from the dramatic fall in energy prices. To be sure, these dynamics make for a convenient and, perhaps, understandable excuse to flee to other sectors. We are happy to report that our manager, Gator Capital, has been constructive on the sector and has used weakness in many of these core names to add to exposure. This sleeve was the only one during the quarter to increase its net exposure. The patience and grounding this takes cannot be overstated. Yes, the fundamentals may not be as robust as they were before the Global Financial Crisis, but the valuations in many financial sector names more than compensates for less than ideal fundamentals. To have someone at the helm of this sleeve that is fully enmeshed in the sector is invaluable. Weaker minds would have had plenty of reasons to look elsewhere.*
>
> *-Q3 Quarterly Update*

In August of 2016, all but three of the financials sleeve's long holdings sported a forward P/E of less than 10x. The average forward P/E of the long book was about 8.4x. Knowing that any catalyst, small or large, could unleash the potential value in these names, Gator, in a very disciplined and risk managed way maintained healthy exposure to the financials sector. With a new post election narrative of higher rates, higher oil prices, potentially less regulation and potentially higher economic growth, financials are now "in play". This sleeve captured more than 100% of the upside to the sector in the quarter and the year. With this new narrative has come a new valuation reality for financials. Gator feels that many of the smaller and mid sized regionals are actually quite pricey. Our short exposure to these banks has been increased markedly in recent weeks. What a difference a few months makes.

Three Thematic Thoughts

The following thoughts are interesting in their own right but also could potentially impact the fund.

Overseas Cash

The new administration has floated the idea of changing the tax code to encourage companies that hold cash overseas to repatriate it back to the United States. The implications for mergers & acquisitions could be significant, especially for the information technology sector. The following analysis by Moody's Investor Services estimates the following:

- $1.77 trillion of cash is held overseas by the 1,000 largest U.S. based nonfinancial companies.
- $861 billion of this cash is held by technology companies or 49% of the total.
- $587 billion of the $861 billion in technology company cash is in the hands of just five companies: Oracle, Cisco, Alphabet, Microsoft and Apple.

As we have noted in prior updates, the buy versus build theme that permeates the technology sector remains firmly in place. If there is a repatriation of this cash, our small cap technology book could be positively impacted. Many of these names would fit nicely within a larger organization.

Energy Demand

With the recent announcement from OPEC regarding productions cuts and the increased attention around electric cars and solar energy, it is easy to forget that there is an interesting demand story around oil and gas that has the potential to be impactful to many of our holdings in the energy sleeve. According to a recent report from India's Oil Ministry, the country's oil consumption in 2016 surged 11% due to rising incomes and the resulting use of cars and trucks. The International Energy Agency expects India to be the fastest growing crude consumer in the world through 2040.

Drug Spending

On a final thematic note we would offer the following reminder as it pertains to drug spending. According to our long/short healthcare manager, 12% of health care spending is on pharmaceuticals and 80% of that spending is on generic drugs. With the prices of biotechnology and pharmaceutical companies coming under pressure one would hope that a small dose of rationality would be administered by those with influential voices. Any rationality around this debate could provide a nice backdrop for our healthcare manager.

Net & Gross Exposure

Net Dollar Exposure		
Current Quarter	Prior Quarter	Average (Since Inception)
37.3%	46.2%	53.3%
Gross Dollar Exposure		
125.8%	124.9%	120.9%
Net Exposure (Delta/Beta Adjusted)		
56.2%	61.7%	56.2%

Source: Sterling Capital Management LLC, FactSet. The daily average net exposure in the fund, on a dollar basis, for the fourth quarter was 42.1%.

The tables above characterize the fund's net and gross exposure on both a dollar basis and a "delta/beta-adjusted" basis. We highlight these two metrics as they are each important in their own right. Dollar exposure is merely a rudimentary way of indicating, in the case of net exposure, the percent of the fund that is long subtracted by the percent of the fund that is short. Gross dollar exposure adds these two numbers together.

More interesting, and applicable, is how the portfolio is positioned after adjusting for the delta in option positions and after adjusting for the beta of each name in the book. Only after adjusting for these two factors can one get a feel for not only how the fund is positioned versus the market, but also how the fund could move in relation to the market. Beware of funds that tout low net exposure on a dollar basis yet have sizable call option positions. While the portfolio, in an up market, may do well despite "low net exposure" this is disingenuous. Just as important, some portfolios with "high net exposure" may actually be positioned quite conservatively if one accounts for put option positions in the book and the individual holdings' respective beta to the market. By expressing our exposure above, in two separate ways, one can get a sense of "dollars invested" as well as "market exposure."

We express exposure on both a dollar and beta adjusted basis in this commentary. While dollar exposure can be managed more precisely than beta adjusted exposure, we feel it is important to also express exposure on this basis as we feel that, over time, it tells a more holistic story.

Sector Exposure (Delta/Beta Adjusted)

The following table illustrates the fund's long, short and net exposure on a sector basis. While the fund's key sector exposures are in energy, financials, health care, information technology, and consumer (discretionary/staples), the portfolio also has exposure, on a limited basis, to other sectors as we allow our managers to own names that may not be classified as being in their sector but are closely related.

	Long	Short	Net
Consumer Discretionary	12.8%	-7.3%	5.5%
Consumer Staples	1.3%	-1.1%	0.2%
Energy	22.5%	-5.7%	16.8%
Financials	39.0%	-23.6%	15.4%
Health Care	17.3%	-7.3%	10.0%
Industrials	0.0%	-0.1%	-0.1%
Information Technology	16.2%	-10.4%	5.8%
Materials	0.2%	0.0%	0.2%
Real Estate	0.0%	-0.3%	-0.3%
Telecommunication Services	3.3%	0.0%	3.3%
Market Hedge	0.0%	-0.7%	-0.7%
Total:	**112.6%**	**-56.4%**	**56.2%**

Market Cap Exposure (Dollar Exposure)

To drill down further, we illustrate below exposure for the fund by market capitalization. In our view, all exposures are not created equal and a healthy exposure to not only large, but also mid and small cap names is important. While large and mid-cap names provide a long/short portfolio with ample opportunity and liquidity, small cap exposure is crucial as these names tend to receive less coverage by the sell-side and lend themselves to being less "efficiently" valued.

	Long	Short	Net	Gross
Large-Cap	21.6%	-9.7%	11.9%	31.3%
Mid-Cap	13.1%	-19.1%	-6.0%	32.2%
Small-Cap	43.6%	-15.4%	28.2%	59.0%

Small: $0-$3 billion, Mid: $3-$10 billion, Large: >$10 billion, excludes derivative securities and market hedges

Closing Remarks

Markets are inherently volatile and unpredictable. Returns in the market and for individual strategies can be quite lumpy. While hope is most certainly not a strategy, we do believe that patience is. To illustrate this point we would offer the following:

- From 1970-2016 the S&P 500 (Total Return) compounded at annualized rate of 10.3%.
- Only twice, on a calendar year basis, did the market's return sport a 10 handle (10.9% in 2004 and 10.1% in 1993).
- Only three times did the calendar year return come within 200 bps of the 10.3% annualized return.
- Only four times did the calendar year return come within 300 bps of the 10.3% annualized return.
- To achieve this 10.3% annualized rate of return, one would have had to stay invested following the market's 37% decline in 2008, 22% decline in 2002 and 26% decline in 1974.
- During this time the market returned more than 30% in a calendar year eight times.

Past performance is no guarantee of future results. The historical examples are not intended to predict the performance of any fund. The S&P 500 index is unmanaged. It is not possible to invest directly in an index.

Returns are lumpy. Equity returns and, by extension, long/short equity returns are not smooth. Our long/short energy manager stated in their most recent letter, "based on our experience we would speculate that more money is made through patience than brilliance". This one quote distills nicely what we feel cannot be emphasized enough.

We want to thank you for the trust you have placed in us and for your support. We look forward to keeping you updated in the months and quarters ahead. Please never hesitate to reach out with any questions or concerns.

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Investors should consider the investment objectives, risks, charges and expenses carefully before investing. For a prospectus or summary prospectus, with this and other information about the fund, please call (888) 228-1872 or visit our web site at www.sterlingcapitalfunds.com. Read the prospectus carefully before investing.

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Technical Terms:

Beta- A measure of the volatility, or systematic risk, of a portfolio in comparison to a benchmark. Delta- The ratio comparing the change in the price of the underlying asset to the corresponding change in the price of a derivative. Median P/E- A median ratio used to compare the price of a fund's stocks with their per-share earnings. A higher price per earnings ratio indicates the market has belief that a company has the ability to increase its earnings. Basis Points- Bps . Forward P/E - a measure of the price-to-earnings using forecasted earnings.

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