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INVESTMENT STRATEGY OUTLOOK – ALL CAP EQUITY

March 31, 2012

FMI All Cap portfolios gained approximately 11.5% in the quarter ending March 31. While positive on an absolute basis, they were behind the 12.87% return of the Russell 3000 Index. From a sector standpoint, our exposure in Finance, Electronic Technology and Industrial Services lagged the market. So-called high beta stocks were the primary drivers of performance in the Russell 3000 this quarter and included a number of stocks that aren't our type of investments such as Bank of America (+72.34%), Citigroup (+38.96%), Apple (+48.04%) and Sears (+108.46%). Apple alone accounted for 1.24% of the performance of the benchmark, so not owning that was a large factor in itself. Of course the Monday morning quarterback would say we were idiots for not owning these stocks but investing is a forward looking endeavor and as we look at the picture today, we believe the stocks we have in each of the aforementioned sectors have a superior 3-4 year outlook, taking the quality of the business franchise, downside risk and valuation into account.

Stocks of homebuilders and those leveraged to a housing recovery have also had a sharp bounce off the bottom and we don't have significant exposure to this area. Weather and consumer confidence were more favorable recently, which aided the optics around this business, but we do not think the data supports a sustained improvement in home building or prices in the near term. We do expect existing home turnover to continue to improve. While people can argue about the exact numbers, it would appear that there are somewhere between 11 and 14 million homes that are in foreclosure, delinquent, or "under water" (market value less than mortgage value). Corelogic and Amherst Securities report that there are 11.2 million homes "in jeopardy," including 4.8 million mortgages that are nonperforming with an expected default rate of 95%. There are between two and three million vacant homes, depending on whose figures are used. New home starts are running at approximately 0.5 million. We think the shadow inventory is very significant and will continue to depress new home building and prices for quite some time. Despite the favorable weather, new home sales were down 5.4% in January and 1.6% in February.

On the positive side, sectors that contributed nicely to our performance in the quarter included Energy Minerals, Producer Manufacturing and Health Technology. Overall, we feel the portfolio of companies is strong and best suited to perform in a bumpy or trendless stock market. If the recent rally is the start of a growth stock-driven environment characterized by expanding valuations, there is a high probability that we will underperform, just as we did in the March quarter. For years we have monitored The Leuthold Group's 46 different fundamental valuation measures for the stock market. These data series typically go back fifty to eighty years. As of the most recent period measured (12/31/11), the average valuation was in the seventh decile (one being the cheapest, ten being the most expensive). While not "negative" on the stock market, we don't think valuations will be a tailwind given very substantial ongoing macro concerns.

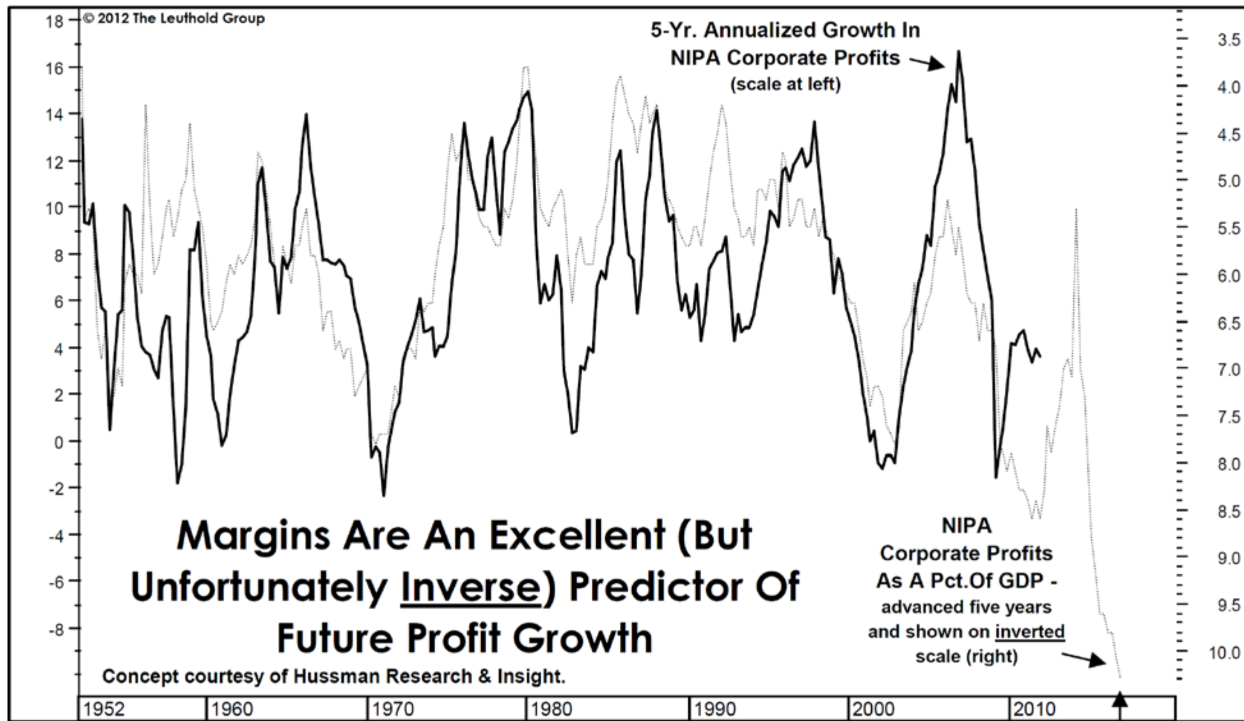
For new investors, the March and September letters include just a brief overview of pertinent investment topics before a couple of specific investment ideas are discussed. The June and December letters are generally longer and usually delve into various macro concepts in more detail.

Investors seem more hopeful that the February employment numbers indicate that the United States is on a healthier economic trajectory. Nonfarm payrolls gained 227,000 in February and finally, both the employment-to-population ratio and labor participation rate inched higher. With over 20 million people unemployed or underemployed, it is a long road back. The labor numbers, however, are notoriously volatile; a year ago we had an almost identical February employment report and then the numbers slipped significantly. One labor commentator indicated that adjusting for this year's balmy winter weather would have resulted in a 90,000 nonfarm gain instead of 227,000 and that if the household survey's figures were replaced by the payroll figures, the unemployment rate would be over 9% rather than 8.3%. Our conversations with businesspeople, with respect to hiring, have turned from uniformly negative over most of last year to more of a mixed bag today. Employment feels like it is getting better, but it is worth noting that wage rates, otherwise known as the price of labor, remain weak.

In spite of the sense that there is a more positive tilt to the employment picture, GDP revisions haven't reflected this over the past six months in the United States. A *Bloomberg News* survey of 63 economists last September averaged 2.2% for estimated 2012 real GDP growth; the March survey had the exact same estimate for 2012. The March 22 report from FedEx, normally a harbinger of near term economic activity, showed a weaker U.S. outlook. Grainger and some other broad-based companies are not seeing a slowdown, however. European and Chinese growth rates, on the other hand, have slowed significantly. Europe may be in a recession right now and China is undoubtedly weakening, although the reliability of their statistics remains very suspect. This fact was revealed recently in a separate *Bloomberg News* story, where the following was stated: "In 2011, the 31 provincial-level governments reported a combined GDP of 51.8 trillion yuan ($8.2 trillion), 4.6 trillion yuan higher than the national figure calculated by the statistics bureau, the state-backed Economic Daily reported in February." Anecdotally, Clarcor, Otis (United Technologies) and a host of other global players are reporting significant declines in their Chinese orders, and real estate prices continue to fall.

The severe debt and budgetary problems across Europe, the United States and Japan have not improved and are likely to continue to weigh on growth. Various programs, such as the European Central Bank's long-term refinancing operation (LTRO), mimic the Fed's monetary actions and have provided a temporary respite from having to actually solve real spending and taxation problems. Greece defaulted, as expected, but what may say more about the future of Greece and perhaps other "peripheral" countries is the fact that the newly issued (post default) Greek debt securities are trading at 29 cents on the dollar. Uncompetitive countries, with structurally high labor rates and high government employment ratios, which are also tied to a high-priced currency, have little chance of establishing a sustainable growth model. The U.S. and Japan continue to pile on debt at a record clip. It is our feeling that the press and the public have grown weary of the debt discussion. Just about the time complacency sets in, we are apt to see something shake us back to reality. The U.S. and Japan are not likely to restructure, and politics are preventing progress towards even balancing budgets, much less reducing debt, so this problem may be with us for a long time.

One of the few economic bright spots over the past several years has been corporate profit margins. As long as they stay near a record high, it makes the valuation argument less negative. Historically, however, profit margins have been quite volatile and unfortunately, have been inversely correlated with future growth. In other words, competitive pressures eventually eat away at high margins, negatively impacting growth, as illustrated in the nearby chart. In a recent article in *The Wall Street Journal*, Brown Brothers reports that corporate profits fell 40 basis points in the December quarter. We'll continue to carefully watch this situation.



This background discussion illuminates why we see uneven terrain for investors. We don't think the big issues are quite yet in the rear view mirror, although we hasten to add that historically we have made money for our investors through some pretty rough market environments. We approach investing with a 3-5 year time frame, knowing there will be periods when we are either out of favor or lose money. Below we highlight a couple of companies that we like for the long haul.

Comerica (CMA)

(Analyst: Matthew Goetzinger)

Description

Comerica is leading super regional bank headquartered in Dallas, Texas with $61 billion in assets. As a relationship based lender, Comerica provides a full range of traditional banking services, focusing the majority of its resources on its core business of commercial banking. The company's geographies include Michigan, California, Texas, Arizona, and Florida. Commercial and industrial loans comprise 56% of total loans, with commercial real estate (25%), consumer (6%), construction (5%), residential mortgage (4%), leases (3%) and international loans (1%) accounting for the remainder.

Good Business

- Geographically, Comerica is one of the more attractively positioned banking franchises. The company benefits from a strong low cost deposit base (80% of funding), with 40% from non-interest bearing accounts.
- Relationship based commercial lending has proven to be durable and recurring in nature.

- Comerica has an enviable track record of credit quality, meaningfully outperforming its peers.
- Commercial and Industrial (C&I) lending exhibits one of the highest returns of any lending product, with returns on equity (ROE) typically in the mid-to-upper teens.
- The company has averaged a 16%+ return on tangible capital.
- Comerica is among the strongest capitalized banks in the industry, with a tier 1 ratio made up of 100% common equity. Balance sheet leverage is below average. Recent "stress tests" highlighted the company's position of strength, with the Fed approving its dividend and share repurchasing programs.

Valuation

- The 10-year ('95-'06) median large cap bank price-to-earnings ratio (P/E) is 12.8. While the stock currently trades at approximately this P/E, it is only 7 times our estimate of earning power.
- Comerica trades at 90% of book value compared to its 10-year median of 124%.
- Strong commercial banks have historically been acquired for two to three times tangible book value, or alternatively, for a 25-35% premium to core deposits. Currently Comerica is valued at tangible book value and parity with core deposits.

Management

- Ralph Babb, 63, has been the bank's President and CEO since January 2002. Babb has successfully managed the bank through a number of difficult environments.
- Karen Parkhill, formerly CFO of Commercial Banking at JP Morgan, recently joined Comerica as CFO. Her background is investment banking, but the recent dialogue has been about improving operating efficiencies and ROE.
- Lars Anderson, 51, formerly with BB&T, joined the company in 2010 and looks like the heir apparent to Babb. His public comments seem to point toward an organic growth focus.
- A significant component of management compensation is tied to ROE.

Investment Thesis

Comerica is levered to a recovery in commercial and industrial lending, most notably in attractive markets like Texas and the Western U.S. Relative to the broader industry, the company is not particularly reliant on retail or commercial real estate banking, two areas that continue to suffer from excess capacity. In addition, Comerica's capital rich balance sheet will allow the bank to capitalize on a resumption of loan demand, and return cash to shareholders. A rebound in profitability should yield an attractive return on equity and an average to above-average valuation.

Illinois Tool Works (ITW)

(Analyst: Karl Poehls)

Description

Illinois Tool Works is a broadly diversified manufacturer with more than 800 operating units. The company's major product lines include consumer and industrial packaging products and systems; construction tools and fasteners; engineered automotive components; foodservice equipment and service; adhesives, sealants, and cleaners; test and measurement equipment; and welding and electronics. Consumables and service & parts account for 66% and 10% of sales, respectively. A disciplined acquisition program complements organic growth and helped drive sales from $5 billion in 1998 to $18 billion in 2011.

Good Business

- Approximately two-thirds of revenue can be considered recurring in nature. The company's sales tend to be more correlated with overall industrial activity than with the more volatile capital goods spending cycle.
- Management operates a disciplined acquisition program, which has added significant economic value over time.
- The company's return on invested capital (ROIC) is meaningfully above its cost of capital and has averaged 15.7% and 14.8% over the trailing 5-year and 10-year periods, respectively.
- Illinois Tool Works generates a considerable amount of excess free cash flow each year, which we estimate will exceed $2 billion in 2012. Over the past decade, the company has returned 60% of free cash flow to shareholders via dividends and share repurchases.
- The balance sheet is solid with $2.8 billion of net debt outstanding. The company's senior unsecured debt is rated A+ by Standard and Poor's and A1 by Moody's.

Valuation

- llinois Tool Works' stock trades for 13.7 times estimated 2012 earnings. This compares to its trailing 5-year and 10-year average P/E multiples of 16.7 and 18.6, respectively.
- Over the past decade, the company's operating margin has averaged 15.5%. It was 15.4% in 2011. This compares to a current enterprise value-to-sales multiple of 1.60 times and the 10-year average of 1.96 times.
- Since 2001, the company's earnings and book value per share have grown at compounded annual rates of 11% and 8%, respectively. Further, the dividend yield is 2.5%.

Management

- The company is led by CEO David Speer, who has been employed at the company since 1978. Over his 34-year career, Mr. Speer has held numerous management roles, was named CEO in 2005 and became Chairman in 2006.
- The company is also led by three Vice Chairmen: Thomas Hansen, Scott Santi, and David Parry. These three executives have been employed by Illinois Tool Works for an average of 25 years.
- The company's executive compensation program includes a direct link to ROIC and management appears to be intensely focused on generating positive economic value for shareholders.

Investment Thesis

Recent concerns about a recession in Europe and Illinois Tool Works' sizable exposure to that region have weighed on the stock's performance. Additionally, the company has about 20% of its business exposed to construction, which continues to be weak. There are also some lingering questions about how to optimize the operating structure of the company. We think these concerns are manageable. Historically, management has employed a highly effective "80/20" approach to improving both the mix and profitability of the business. At our purchase price, we were able to invest in a highly diversified global industrial franchise, with leading returns on capital, and at a valuation that was near decade lows.

Thank you for your confidence in Fiduciary Management, Inc.

Fiduciary Management Inc.
All Cap Equity Composite
12/31/2007 - 12/31/2011

Year	Total Return Gross of Fees %	Total Return Net of Fees %	*Benchmark Return %	Number of Portfolios	Dispersion %	Three Year Ex-Post Standard Deviation		Total Composite Assets End of Period ($ millions)	Total Firm Assets End of Period ($ millions)	Percentage of Firm Assets %
						Composite	*Benchmark			
2008	-26.65	-27.18	-37.31	12	0.60	n/a	n/a	$ 56.9	$ 4,062.5	1.40%
2009	30.19	29.35	28.34	18	0.23	n/a	n/a	$ 86.9	$ 7,008.9	1.24%
2010	18.20	17.41	16.93	18	0.26	n/a	n/a	$ 103.3	$ 9,816.0	1.05%
2011	3.85	3.14	1.03	23	0.41	19.57%	19.35%	$ 127.4	$ 12,273.6	1.04%

*Benchmark: Russell 3000 Index®

Returns reflect the reinvestment of dividends and other earnings.
The above table reflects past performance. Past performance does not guarantee future results. A client's investment return may be lower or higher than the performance shown above. Clients may suffer an investment loss.

Fiduciary Management, Incorporated (FMI) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. FMI has been independently verified for the periods 12/31/1993 - 12/31/2011. 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. The All Cap Equity composite has been examined for the periods 12/31/2007 - 12/31/2011. The verification and performance examination reports are available upon request.

FMI was founded in 1980 and is an independent investment counseling firm registered with the SEC and the State of Wisconsin. The firm manages over $12.2 billion in assets of pension and profit sharing trusts, mutual funds, Taft-Hartley funds, insurance company portfolios, endowments and personal trusts. The firm includes both institutional and mutual fund business. Although the firm has participated in wrap programs, it is a separate and distinct business, and is excluded from firm-wide assets.

The FMI All Cap Equity Composite was created in December 2007. These accounts primarily invest in small, medium and large capitalization US equities.

The FMI All Cap Equity Composite reflects time-weighted and asset-weighted returns for all discretionary accounts. From December 31, 2007 all accounts were managed for at least one month. All returns are calculated using United States Dollars and are based on monthly valuations using trade date accounting. All accounts in this composite are fee paying. Gross of fees returns are calculated gross of management fees and custodial fees and net of transaction costs. Net of fees returns are calculated net of actual management fees and transaction costs and gross of custodial fees.
Dispersion is calculated using the standard deviation of all accounts in the composite for the entire period. As of 12/31/2011, the trailing three year annualized ex-post standard deviation for the Composite and Benchmark are required to be stated per GIPS®.

Currently, the advisory fee structure for the FMI All Cap Equity Composite portfolios is as follows:
Up to $25,000,000 0.75%
$25,000,001-$50,000,000 0.65%
$50,000,001-$100,000,000 0.60%
$100,000,001 and above 0.55%

The firm generally requires a minimum of $3 million in assets to establish a discretionary account. High Net Worth individuals may establish an account with a minimum of $1,000,000, however, the firm reserves the right to charge a minimum dollar fee for High Net Worth individuals depending on the client servicing involved. The minimum account sizes do not apply to new accounts for which there is a corporate, family, or other substantial relationship to existing accounts. In addition, the firm reserves the right to waive the minimum account size and minimum annual fee under certain circumstances. A complete list and description of all firm composites is available upon request.
Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

The Russell 3000 Index® measures the performance of the largest 3,000 U.S. companies representing approximately 98% of the investable U.S. equity market. The All Cap Equity composite uses the Russell 3000 Index® as its primary index comparison.