FIDUCIARY MANAGEMENT, INC.
Investment Counsel

100 East Wisconsin Avenue, Suite 2200
Milwaukee, Wisconsin 53202
414-226-4545
www.fiduciarymgt.com

INVESTMENT STRATEGY OUTLOOK – ALL CAP EQUITY

June 30, 2012

FMI All Cap portfolios declined approximately 2% in the quarter ended June 30, while the Russell 3000 Index dropped 3.15% in the period. Year-to-date the portfolios are up about 9.3%, essentially in line with the Russell 3000. Our lack of Utility and Communications exposure hurt relative performance in the quarter. Furthermore, a few of our recent additions have performed sluggishly out of the gate, but as long term investors, we look out several years for a stock's market value to better reflect intrinsic value. Naturally we would like to time our purchases at the beginning of a long and strong rise in the stock price rather than 20% too early or too late. As the old bromide goes, "I'm not against short term performance. I just don't know how to achieve it." Energy stocks, particularly Devon and McDermott International, took it on the chin in the June quarter but we remain optimistic about their long term thesis. Additionally, other economically sensitive stocks such as Arrow Electronics and SPX Corporation hurt too. Portfolios are rarely as defensive as one would like when the economy goes soft or as aggressive as one would hope when the economy starts to improve.

Considering how much has been written about the many macro issues that litter the landscape, one more voice hardly seems to matter. Nevertheless, there is an important yet odd aspect related to how the markets seem to be digesting these big picture issues, and this is the primary subject of the letter -- but first we will briefly summarize the critical elements in this global drama. As an aside, our opinions and prior discussion on these subjects are well documented and can be found on our website, www.fiduciarymgt.com.

The quick summary is that the eurozone, Japan and the United States remain in deep debt and fiscal crises, many European countries are either in recession or appear to be moving toward it, China and Brazil are slowing significantly, and the United States economy appears to be weakening. The CRB Commodity Index is off over 20% since February. A few well-respected commentators, including John Hussman, believe the U.S. has already entered a recession, although some data, such as housing starts and the Case Schiller Home Price Index, have improved. Many global banks have recently been downgraded as rating agencies question their ability to weather what look like not only tougher economic conditions, but perhaps a domino-effect sovereign debt debacle. Central banks, particularly the European Central Bank (ECB), the Bank of Japan and The Fed, have conjured up trillions of currency units in a vain attempt to get economies moving. On the fiscal front, the U.S. has added over $5 trillion to its total debt load over the past four years and now finds its total debt-to-GDP higher than the aggregate eurozone countries. Leaders seem perplexed that their money printing and deficit spending are not putting our collective financial houses in order.

The latest (June 28-29) European crisis summit -- the eighteenth such summit, if one is counting -- espoused the strongest effort yet to exert fiscal constraints on the eurozone countries. There were three basic proposals: (1) the creation of a eurozone bank supervisor; (2) more bailout funds will be made available directly to banks; and (3) loans to Spanish banks will not be senior to existing debt. Additionally, there may be measures that would allow Brussels to rewrite the sovereign budgets of countries that break debt and deficit rules, in an effort to win German approval of euro bonds, which they have heretofore adamantly opposed. The European Union will have the ability to levy fines for noncompliance. Fines? Countries owing hundreds of billions of euros are going to snap-to over a million or two in fines? The degree to which the leaders do not get it can be illustrated by a few recent anecdotes. Spain's Prime Minister, Mariano Rajoy Brey, said on May 26 that his country's banks did not need a bailout. Within a week Spain was asking for $27 billion. A week later Spain asked the eurozone community for $127 billion! In a separate story, Spanish workers, apparently not satisfied with five to six weeks of paid vacation, won a favorable ruling in June from the Court of Justice of the European Union, who ruled that workers who became sick during their vacation were entitled “make-up” vacation days. Not to be outdone by the Spanish, France’s new president, Mr. Hollande, promoted a lower retirement age within weeks of taking office.

Waiting in the wings of the euro debt crisis is, of course, the International Monetary Fund, or IMF (the U.S. taxpayer is the largest contributor) and most likely The Federal Reserve of the United States. The Fed has renewed swap lines with the ECB, and given Mr. Bernanke’s philosophy and track record, there is little doubt that U.S. taxpayers will be the lenders of last resort if things spiral out of control in Europe. As we have commented in the past, programs to provide or improve liquidity don’t address the structural problem, which is insolvency. There is too much sovereign debt in the eurozone countries and the European banks appear to lack adequate equity. Banks’ ownership of suspect sovereign debt, not to mention highly overvalued real estate, makes asset values questionable. Restructuring is what is needed, not a liquidity lifeline.

Despite some daily volatility, the market’s response to all of this has been remarkably docile. In fact, nearly every time there is a whiff of more money printing or new stimulus (deficit spending), or “coordinated action,” the market has a mini-rally. Once investors realize the same old problems exist, stocks retreat. Overall valuations remain strangely elevated. Typically when the media and Wall Street are rife with negative macro commentary, stock market valuations reflect this. Normal contrarian indicators, like the May *Financial Times* piece saying the “cult of equities is dead,” harken back to the “Death of Equities” *Business Week* cover in 1979. Markets are generally swayed by big swings of emotion (fear and greed) and for a number of years the media has blared a steady tune of very significant negative realities. One could argue that the prevailing macro concerns are as wide and deep as have possibly existed since the early to mid-1970s. Yet valuations remain well above average from a long term historical basis and miles away from valuations that persisted in the 1970s. Each quarter we analyze approximately 48 different valuation measurements for the stock market, with most of the data series going back multiple decades. We’ve discussed these valuation parameters numerous times in previous letters. The median valuation decile of these 48 measures as of March 31 (there is always a quarter lag) was 7.5 (10 being the most expensive decile and 1 being the cheapest). After years of choppy stock markets and all of the negative publicity, this must be an astonishing figure to casual observers.

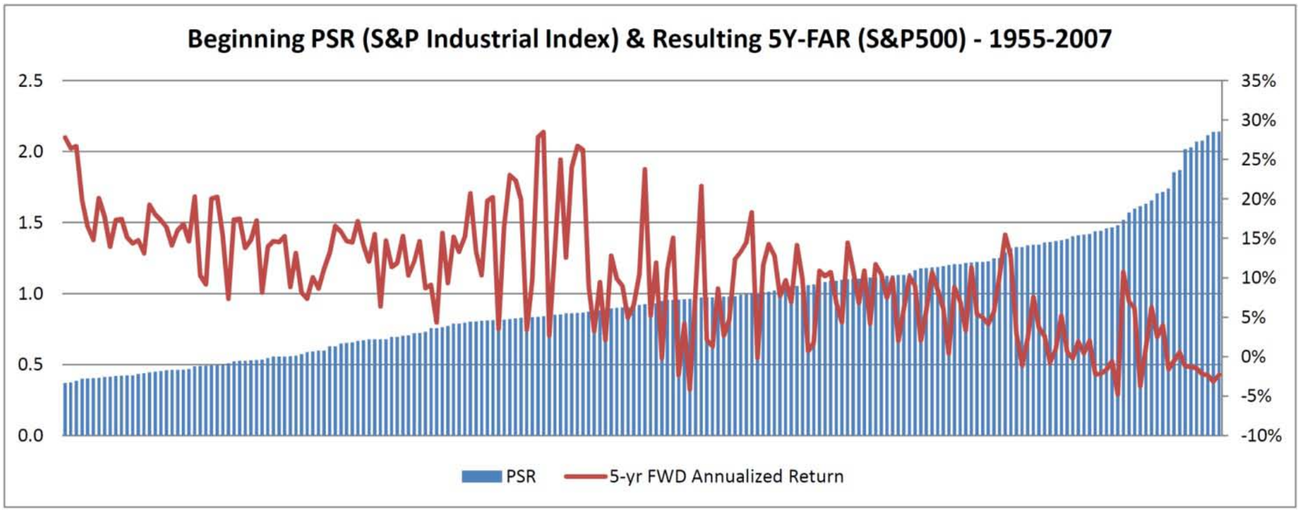
There is a strong relationship between future stock market returns and the starting point of valuation. It is an obvious conclusion: cheap markets beget excellent returns and vice versa. Consider the accompanying charts compiled by one of our analysts, Dan Sievers. We analyzed the price-to-sales ratio (PSR) for the S&P Industrials for every quarter since the end of 1955 and then broke the data into deciles and subsequent five year compound rates of return for the S&P 500. The data is consistent across almost all of the 48 valuation series we monitor, not just the PSR data shown here. The second graph is perhaps the more powerful depiction, with the bars representing price-to-sales ratios and the line representing subsequent five year returns.

S&P Industrial Index - Quarterly Price-to-Sales Ratio (PSR) &
S&P 500 Index - Subsequent 5-Year FWD Annualized Returns (5Y-FAR)
206 quarters (4Q1955-1Q2007)

PSR Deciles	**PSR Range**			**Decile Dispersion**	**Average PSR**	**Average 5Y FAR**
1	0.37	-	0.46	0.09	0.42	17.9%
2	0.46	-	0.56	0.10	0.52	14.5%
3	0.56	-	0.71	0.14	0.65	12.5%
4	0.72	-	0.83	0.11	0.79	14.3%
5	0.83	-	0.92	0.09	0.87	13.2%
6	0.93	-	1.00	0.07	0.97	8.2%
7	1.01	-	1.11	0.10	1.07	9.0%
8	1.12	-	1.23	0.11	1.18	6.9%
9*	1.25	-	1.44	0.19	1.36	3.4%
10	1.46	-	2.14	0.68	1.78	0.5%

*Last Quarter PSR (3/31/2012) was 1.28 (lower 9th decile)

The PSR data shows the market to be significantly above average today. Some of the other data series, particularly the price-to-earnings (P/E) ratio series, put valuations closer to the sixth decile. P/E ratios are undoubtedly lower as the "E" is benefiting from near record high corporate margins. Overall, as mentioned, we appear to be between the seventh and eighth deciles, which is certainly not what one would expect reading today's dire headlines.



Sources: The Leuthold Group and Fiduciary Management, Inc.

There seems to be an undying belief that just because negatives are being discussed publicly, somehow this automatically means these conditions are incorporated into stock prices. For the stock market to decline, surprises (as this theory goes) have to be negatives that are heretofore unseen. It is hard for us to believe that the epic challenges that face the U.S. and world are somehow already discounted into a market trading in the 7th or 8th decile of valuation. Why this dichotomy? There is the relatively obvious answer that inflation is subdued and interest rates are low. While this is indeed a fact based on a snapshot view, central banks have been operating in near emergency mode for almost four years and fiscal authorities have been "stimulating" the economy nearly nonstop with a flood of borrowed money for half a decade. Ground hugging interest rates and $1.5 trillion annual deficits reflect a crisis, not normal conditions for economic and business development. One could add that corporate profitability is relatively strong, balance sheets are solid and energy prices have retreated. These are all legitimate positives, however, valuations have been elevated for over a decade so it's difficult to say that these factors explain the long period of high valuations. There may be a couple of other explanations that haven't received a lot of air time.

Perhaps there is something to the supply and demand theory of equities. The number of public companies has fallen dramatically over the past fifteen years—38% since 1997 according to *The Economist*. The number of initial public offerings has declined from an average of 311 per year from 1980-2000 to 99 per year from 2001-2011. The Sarbanes Oxley Act of 2002 as well as other heavy-handed regulation, the growth of private equity funds and perhaps simple cyclical factors, all play a role. Very large share buybacks and modestly lower option-related share issuance have also shrunk the pool of investable equity. We calculated that just in 2011 alone, for the Russell 3000 Index, there was a $332 billion net shrinkage of capital stock.

Another significant factor in the relatively high prevailing market valuation may be related to the institutionalization of the money management business. Money is concentrated into fewer managers. Large money managers have asset bases to protect. Consultants police the money managers and may keep them from raising cash or moving between asset classes. Players have a vested interest in saying everything will work out and not to worry. Perhaps in the "old days" the individual investor could be counted on to panic and drive the market down when there was a plethora of worries. Today, the individual or "retail" investor has largely disappeared. The big fund managers whistle by the graveyard and hope for the best.

An additional explanation might have something to do with demographics, particularly as it relates to lifecycle investment patterns. Baby boomers constitute the peak equity investing demographic. While still employed, boomers have the willingness and the capacity to bear the "risk" of equity investment (at least "risk" as defined by finance textbooks) and the need for capital appreciation before retirement. Thus, boomers supply the "demand" for equities, which helps to explain persistently high valuations despite less-than-ideal conditions. As this age group approaches retirement, they may increasingly shift from stocks to "less risky" fixed income instruments. However, given the money printing we've seen in the developed world over the last four years, we suspect that boomers will regret any further transition from stocks to bonds.

Are we in a permanent state of higher valuations? It is possible, but we wouldn't stake our reputation on it. Perhaps the aforementioned factors will keep panic at bay in the future. It is certainly true that retrospectively, the market "should" rarely panic. If investors had acted sensibly, those great buying opportunities at low valuations shouldn't have occurred: 1932, 1937, 1942, 1962, 1974, 1982, 1987, 1990 and 1991. Rational professionals wouldn't have let it happen. Perhaps the last feast for the individual investor, the "dumb" money, was the technology and telecom bubble of the late 1990s. So-called day traders do not seem as prevalent today as they did in this period. It is interesting to note that in the last two market swoons, 2001-2002 and 2008-2009, valuations only declined to approximately the median. The market never saw the first through fourth decile valuations in either one.

We are not suggesting that today's market *deserves* the same valuation as the bad markets of the past 80-some years, but we do find it difficult to take comfort in today's valuations, with the implicit assumption that the human emotions of greed and fear have been checked. Absent realistic tactics to address some of the most important macro concerns, we don't anticipate a sunny valuation future. In short, we remain prepared for ongoing difficult times. This is not to say we expect poor returns for our portfolios. The past ten years haven't been good for the stock market averages, yet we have managed to make pretty solid returns for our clients. We hope to do the same in the future but it looks likely to occur in a grind-it-out type of market, fighting valuation along the way.

We are comforted by the portfolio companies: durable business franchises with strong balance sheets. In most cases they produce products and services that are based on needs rather than wants. We believe the companies are stronger-than-average yet the portfolio trades at a significant discount to the market. On a weighted average basis, the all cap portfolios trade at approximately a 45% discount to the Russell 3000 on a price-to-sales basis and a 30% discount on a trailing twelve months' P/E basis.

Lastly, we don't want to obsess about valuation. Yes, the numbers unequivocally put March 31 decile valuation at approximately 7.5. Some investors focus exclusively on P/E ratios. Within the 48 measures that we monitor, there are eighteen P/E series. The average of these series is 6.6. In the table cited earlier, we've included a column labeled "decile dispersion." Note that the bands are fairly narrow in the 1^{st} through 8^{th} deciles. Movement between these deciles is far easier (in both directions) than is the case in the 9^{th} and 10^{th} decile. Not that long ago the markets were at the upper end of the 10^{th} decile, so we've come a long way already. In fact, if valuations moved just half of what they have already, we would be near the 3^{rd} decile. With a fairly bumpy June quarter behind us, the valuation picture is already looking a touch better.

Thank you for your support of Fiduciary Management, Inc.

Fiduciary Management Inc.
All Cap Equity Composite
12/31/2007 - 03/31/2012

Year	Total Return Gross of Fees %	Total Return Net of Fees %	*Benchmark Return %	Number of Portfolios	Dispersion %	Three Year Ex-Post Standard Deviation Composite	Three Year Ex-Post Standard Deviation *Benchmark	Total Composite Assets End of Period ($ millions)	Total Firm Assets End of Period ($ millions)	Percentage of Firm Assets %
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%
Q1 2012	11.56	11.42	12.87	26	0.13	16.96%	16.79%	$ 165.1	$ 14,145.3	1.17%

*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 - 03/31/2012. 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 - 03/31/2012. 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 $14.1 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.