FIDUCIARY MANAGEMENT, INC.
Investment Counsel

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INVESTMENT STRATEGY OUTLOOK – INTERNATIONAL EQUITY

December 31, 2019

International stock markets continued to rally in the fourth quarter, as quantitative easing (QE), a "phase one" U.S.–China trade deal, and the UK election (providing some Brexit clarity) drove markets higher. The FMI International portfolios gained approximately 5.3% in the period, which compares with an MSCI EAFE Index return of 5.19% in local currency and 8.17% in U.S. Dollars (USD). The Distribution Services, Industrial Services, and Retail Trade sectors were strong relative performers for the portfolio, while Health Technology, Producer Manufacturing, and Process Industries each weighed down the results. Ferguson, Schlumberger, and Samsung Electronics were among the top individual contributors, as Unilever, Smith & Nephew and Chubb detracted.

For the full calendar year, the international portfolios added approximately 18.1%, lagging the MSCI EAFE's advance of 21.67% in local currency and 22.01% in USD. We had some tough stocks in 2019, but we believe the strategy is positioned well. Our cash has weighed on relative performance, as has our value orientation in this growth and momentum-driven market. The MSCI EAFE Growth Index outperformed the MSCI EAFE Value Index by 11.81% this year (27.90% versus 16.09%) -- a huge spread. Animal spirits have driven this bull market, while fundamentals have become an afterthought. Earnings are set to decline in the Eurozone, UK and Japan in 2019,[1] yet stock prices seem to go nowhere but up.

Valuations remain elevated across asset classes. Stocks are expensive, as we estimate that the MSCI EAFE Index trades at nearly 25 times trailing earnings per share (EPS), which is far from a bargain. Bond markets are even more egregious. Greece joined the negative-rate debt issuers club, despite significant doubts over the long-term sustainability of their debt.[2] More than a dozen European "high-yield" junk bonds also crossed the negative-yielding threshold earlier this year, which is an eye-opening oxymoron.[3] Neither phenomenon should exist, which illustrates the extreme excess and manipulation in today's financial markets. Experimental central bank policies have forced investors into more precarious and less-liquid assets, making traditionally safe investments risky, and speculative investments outright dangerous.

Recent Developments

As stocks levitate, global real GDP growth continues to sputter, projected by the Organisation for Economic Co-operation and Development (OECD) at only 2.9% in 2019 and 2020. Per International Monetary Fund (IMF) managing director Kristalina Georgieva, "In 2019, we expect slower growth in nearly 90 per cent of the world. The global economy is now in a synchronized slowdown."[4] In the Eurozone, manufacturing activity has fallen for 11 straight months, with Germany particularly weak.[5] The UK narrowly avoided a recession with 0.3% growth in the third quarter. In Japan, exports have fallen for 12 straight months, and a nationwide sales tax hike is weighing on private consumption.[6] China's third quarter GDP growth came in at 6.0%, a 30-year low,[7] while U.S. growth is expected to fall to just 2.0% in 2020 (from 2.3% in 2019).[8]

On the flip side, a "phase one" U.S.–China trade deal and the UK election may be reasons for optimism. Tariffs have clearly hurt China, and while it is debatable whether this was the right approach, it did bring China to the bargaining table. Some good may come of it in the end, though it's too early to tell. The trade deal reduces some of the tariffs on Chinese goods, and China has agreed to increase purchases of U.S. goods and services by at least $200 billion

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[1] Mislav Matejka, Prabhav Bhadani, and Nitya Saldanha. "Global Developed Markets Strategy Dashboard." Pg. 9. *J.P. Morgan*. December 16, 2019.
[2] Tommy Stubbington. "Sub-zero yields defy economic logic." *Financial Times*. November 17, 2019.
[3] Paul J. Davies. "Oxymoron Alert: Some 'High Yield' Bonds Go Negative." *The Wall Street Journal*. July 14, 2019.
[4] James Politi. "IMF chief urges work on impact of negative rates." *Financial Times*. October 8, 2019.
[5] Valentina Romei. "Eurozone activity nearly stagnant." *Financial Times*. December 16, 2019.
[6] Stanley White. "Japan shares fall on weak export data, profit taking." *Reuters*. December 18, 2019.
[7] Don Weinland, Sun Yu, Xinning Liu. "China's pace of growth hits 30-year low." *Financial Times*. October 18, 2019.
[8] Laurence Boone. "OECD Economic Outlook" Presentation. November 21, 2019.

(including $32 billion in agriculture) over the next two years. China is expected to improve protections for intellectual property rights, technology transfer practices, access to financial services, and dispute resolution. Lastly, China will refrain from competitive currency devaluations or targeting its exchange rate for a trade advantage.[9] Though it sounds great on paper, enforcement may be a challenge. China President Xi Jinping is a dictator and has demonstrated a willingness to do just about anything to move his agenda forward. Democratic principles and free speech are limited. Expecting Xi to conform and play by the rules may be wishful thinking. Elsewhere, Prime Minister Boris Johnson's election victory has the UK on course to exit the European Union by January 31, a step in the right direction. That said, Johnson has ruled out prolonging the Brexit transition period (where they can negotiate a trade, political, and security agreement) beyond 2020, creating another potential "cliff-edge" situation at year-end.[10]

On the QE front, the combined money printing presses of the European Central Bank (ECB), Federal Reserve (Fed), and Bank of Japan (BOJ) are churning out over $1 trillion on an annual run rate. The ECB continues with a €20 billion-a-month program that they kicked off in September. In October, the U.S. announced the purchase of $60 billion per month of treasury bills, through at least the second quarter of 2020, in response to a lack of liquidity and spike in rates in overnight money markets.[11] While Fed Chairman Jerome Powell claims "in no sense is this QE," we are not buying it. In Japan, the BOJ continues to actively purchase Japanese Government Bonds (JGBs) and exchange-traded funds (ETFs), and now owns an astonishing 46.5% of the country's JGBs[12] and close to 80% of its ETFs.[13]

<u>Corporate Debt – Flashing Red?</u>

Worldwide, debt continues to pile up to remarkable levels. According to the Institute of International Finance (IIF), global debt has reached a record high of over $250 trillion (320% of GDP) and is on pace to grow at ~4.8% in 2019, much faster than the growth of the global economy. Total debt is up over $100 trillion (+67%) from 2007, with corporate debt (+95%) and government debt (+114%) growing at an accelerated pace.[14] While we view government debt (especially at negative yields) as having significant long-term risks, the corporate side of the ledger could have more of an immediate impact. In a November presentation, the OECD warned that low-quality debt has reached a high level, with BBB (which is the rating just above non-investment grade) bonds accounting for nearly 50% of the total issuance of investment-grade credit, up from ~25% in 2000.[15] This could be problematic if we enter into a downturn, as issuers that get downgraded from BBB (often referred to as "fallen angels") face a significant increase in borrowing costs.

In a recent deep-dive report, J.P. Morgan (JPM) analyst Steven Alexopoulos and team write that they see a "perfect storm brewing for a major credit cycle downturn with a corporate debt bubble now in sight." Among other factors, JPM calls out negative interest rates, a rapid rise in global corporate debt, growth of BBB-rated bonds and leveraged loans (outside of banks), a decrease in covenant protection, favorable ratings issued by ratings agencies, passive bond funds with a high BBB-concentration, and increased corporate leverage ratios. At the end of 2018, leverage ratios (debt-to-EBITDA[16]) in the U.S. for investment grade debt were 2.16 times versus a long-term average of 1.67 times. For BBB-rated debt, it was much higher, at 3.08 times versus 2.51 times.[17] We find it telling that the rating agencies appear to have moved the goal posts in terms of what constitutes a BBB-credit. How far will they allow companies to push the limits in a recession?

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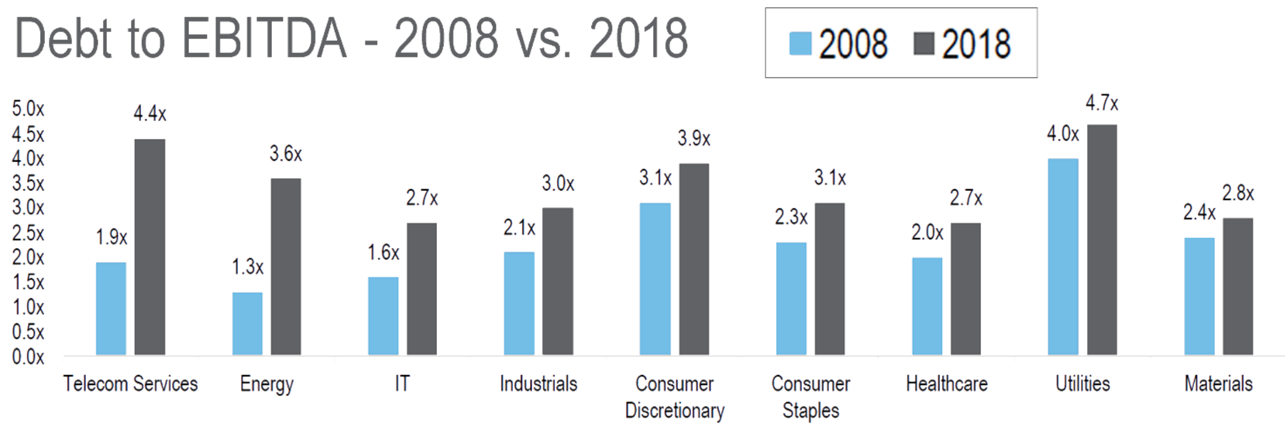
[9] "What's in the U.S.-China 'phase one' trade deal." *Reuters*. December 13, 2019.
[10] Jonathan Stearns. "EU Warns of Brexit Cliff as Johnson Rules Out Longer Transition." *Bloomberg*. December 17, 2019.
[11] Fred Hickey. "The High-Tech Strategist." Issue #382. November 1, 2019.
[12] "Japan's Economy and Public Debt Management." Pg. 23. Ministry of Finance, Japan. December 2019.
[13] "Japan's Economy and Monetary Policy." Pg. 13. Bank of Japan. December 2019.
[14] "Global Debt Monitor." Institute of International Finance. August and November, 2019.
[15] Laurence Boone. "OECD Economic Outlook" Presentation. November 21, 2019.
[16] Earnings before interest, taxes, depreciation, and amortization.
[17] Steven Alexopoulos, Alex Lau, Anthony Elian, Janet Lee, Nikhil Potluri. "U.S. Mid- and Small-Cap Banks Credit Cycle Playbook." *J.P. Morgan*. December 17, 2019.



Source: McKinsey & Company; presented by Steven Alexopoulos, Alex Lau, Anthony Elian, Janet Lee, and Nikhil Potluri. "U.S. Mid- and Small-Cap Banks Credit Cycle Playbook." J.P. Morgan. December 17, 2019.

In their October 2019 Global Financial Stability Report, the IMF makes a disturbing admission: "Corporate sector vulnerabilities are already elevated in several systemically important economies as a result of rising debt burdens and weakening debt service capacity. In a material economic slowdown scenario, half as severe as the global financial crisis, corporate debt-at-risk (debt owed by firms that are unable to cover their interest expenses with their earnings) could rise to $19 trillion — or nearly 40 percent of total corporate debt in major economies — above crisis levels."[18] Wow. Investors don't seem all that concerned about leverage today, but that can change in the blink of an eye.

Japan Observations

On a recent research trip to Japan, we met with a wide range of government officials and company management teams. Sitting down with the Monetary Affairs Department of the BOJ, it became clear that they still believe there is plenty of room to take rates lower (they're already in negative territory!), and significant capacity to buy more JGBs and ETFs, which is alarming. In one of the slide decks, there was a mention of "strengthening the framework for continuous powerful monetary easing." Despite 20 years of aggressive monetary policies, and very little to show for it, they did not seem open to suggestions that these policies do not work and could be making the situation worse. Clearly, their blinders are on.

When meeting with the Bureau for Japan's Economic Revitalization, we were surprised to see an unwavering enthusiasm toward increasing the labor participation rate in women and the elderly, a key tenet of their growth strategy. While the number of women in the workforce is up by 2.9 million since 2012, birth rates continue to plummet despite the government's best efforts to provide free early childhood and tertiary education, daycare and babysitting subsidies.[19] We wonder if this initiative is pulling forward demand at the expense of future generations. We are equally skeptical that engaging the elderly will be a sustainable solution. Ultimately, Japan has a people problem; the working age population continues to decline (down 5 million from 2012-18), which is difficult to outrun. Productivity improvements can only go so far. If productivity were to grow at 2%, you would need 50 workers that are 2% more productive to replace one worker exiting the workforce. With Japan's productivity falling to 0.5% last year, it's no surprise that GDP growth is slower today than it was in 2012.[20] Without more babies, Japan will need to be more accommodating toward immigration in order to grow.

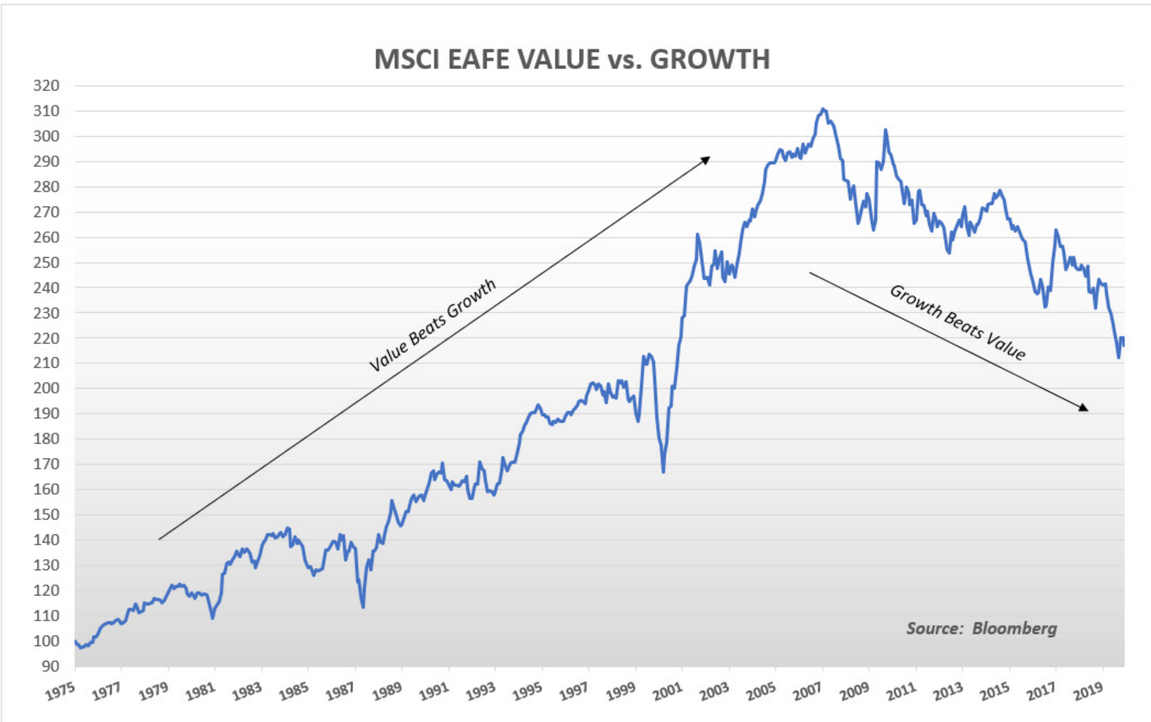
The company meetings were much more productive. There appears to be near uniform progress in terms of Japanese companies adopting more of a returns-based focus. Virtually every company referenced return on equity

[18] International Monetary Fund. 2019. *Global Financial Stability Report: Lower for Longer*. Washington, DC, October.
[19] "The Basic Facts of the Japanese Economy." Cabinet Office. December 2, 2019.
[20] OECD data. https://data.oecd.org/lprdty/gdp-per-hour-worked.htm

(ROE), and an increasing number are incorporating return on invested capital (ROIC) into the management of their businesses (music to our ears). In addition to catching up with our existing holdings (Isuzu, Samsung, Secom and Sony), we had a number of other encouraging meetings, and added several new stocks to our Monitor and Wish Lists, including a few that we are actively researching.

Value is in the Eye of the Beholder

To say it's been a challenging time for value investing would be an understatement. Growth has beaten value in developed international markets for well over a decade, as illustrated in the chart below (the downward sloping line depicts growth beating value). This is indicative of the speculative, momentum-driven market that we have had for quite some time, which has been aided by aggressive central bank policies (QE, negative rates, etc.) and a massive shift from active to passive investing. As a reminder, passive index funds and ETFs purchase equities (and fixed income) without regard for valuation. Inevitably, when fear returns to the market, there will be a time when these very same passive vehicles are selling indiscriminately.



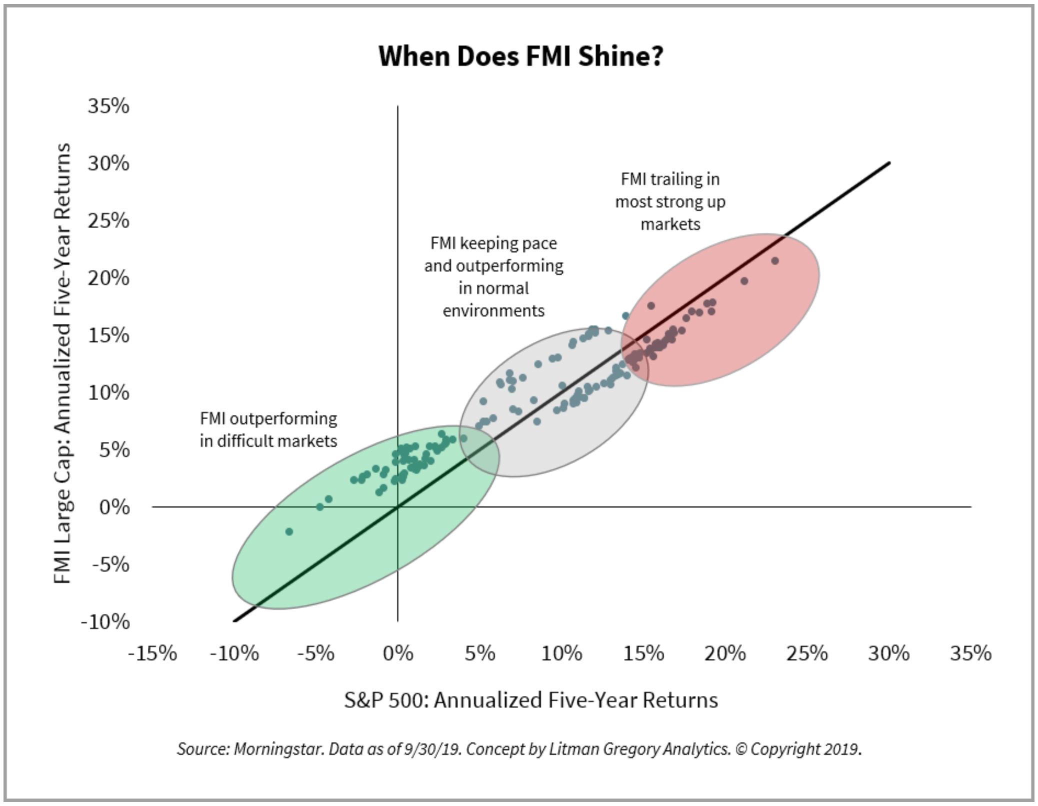
History books point to a plethora of empirical evidence documenting value's considerable outperformance over long periods of time. We believe recent times are the exception, not the rule. It comes back to human nature, as investors will inevitably be too optimistic on the way up, and pessimistic on the way down. For the MSCI EAFE, the full body of evidence continues to favor the value discipline, despite a lost decade. Since inception (December 1974), the MSCI EAFE Value Index has returned a cumulative return of 9,430% (10.65% annualized), which is nearly 2.5 times the MSCI EAFE Growth Index return of 3,835% (8.50%).[21] We do not believe the fundamental emotions that drive investor behavior will ever change; greed will eventually transition to fear, as it has for generations. We remain committed to our core value principles.

FMI: What to Expect

If you could design a stock market environment where FMI would likely underperform – growth and momentum-driven, 20%+ return, debt-fueled mergers and acquisitions, expensive valuations, and a disregard for business

[21] Bloomberg data.

fundamentals – this would be the one. However, when times get tough, we tend to excel. If we were to summarize the FMI value proposition in a single chart, it would be the following by Litman Gregory, a leading advisor and consultant.



The chart features our nearly 18-year track record of our domestic FMI Large Cap Fund (FMIHX),[24] which shares the same investment principles as the FMI International equity strategy. It shows FMI trailing in most strong up markets, keeping pace and outperforming in normal environments, and outperforming in difficult markets. Downside risk avoidance is paramount, which has been the key to full-cycle outperformance in all of our investment strategies since their inceptions. We believe we have a successful formula that has withstood the test of time.

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Performance	Q4 2019	One Year	Three Years	Five Years	Ten Years	Since Inception
FMIHX	**5.80%**	**23.66%**	**12.31%**	**9.48%**	**11.59%**	**9.29%**
S&P 500 Index	9.07%	31.49%	15.27%	11.70%	13.56%	8.08%

Inception: December 31, 2001

Note: Returns for periods less than one year are not annualized. Returns may not match those reported by other sources such as Morningstar due to slight valuation differences at the end of the reporting period.

Performance data quoted represents past performance; past performance does not guarantee future results. 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 their original cost. Current performance of a Fund may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by visiting www.fmifunds.com or by calling 1-800-811-5311. The returns do not reflect the deduction of taxes that a shareholder would pay on Fund distributions or the redemption of Fund shares.

As of the Fund's Prospectus dated January 31, 2019, and supplemented August 12, 2019 and September 9, 2019, the FMI Large Cap Fund Investor Class annual operating expense ratio is 0.80%.

As a reminder, Fiduciary Management, Inc. (FMI) is independently owned and has managed money for 40 years in the same disciplined, fundamentally-driven, and value-oriented way. FMI operates from a single office in Milwaukee, Wisconsin, away from the bustle and groupthink often prevalent in big cities. We are not a "product shop;" we have one investment team, one philosophy and one process. We do not manage any hedge funds. We're not like many large investment managers who constantly open new funds and strategies, and close underperforming ones. Thousands of mutual funds have been closed or merged over the last decade; it certainly makes peer group statistics look suspect! Instead, we stick to our knitting, and our team invests right alongside our shareholders and clients. FMI has a focused approach to investing, with high active share. We are the antithesis of an index fund. While not popular today, this approach has been both a winning one, and a less volatile one, over the long run.

FMI's investment philosophy can be summarized as follows:

- We seek undervalued stocks. That typically occurs when there is a cloud over the business.
- We make our research count by focusing on a limited number of companies for the portfolio.
- We invest in businesses that are likely to earn above their cost of capital over a business cycle.
- We invest in management teams who we believe will act like shareholders.
- We are highly attuned to avoiding value traps, i.e., secularly-challenged businesses.
- We want to minimize financial risk by sticking to companies with good balance sheets.
- We focus on the downside risk before the upside opportunity.

To use a baseball analogy: we try to bat for average. We look to hit singles and doubles and avoid the strikeouts, unlike those who swing for the fences. As Howard Marks likes to say, and we would reiterate, "If we avoid the losers, the winners take care of themselves."

To Hedge, or Not to Hedge

Before launching the FMI International Strategy nine years ago, we studied the pros and cons of currency hedging, and determined that it was generally a wash over a long period of time. We decided to launch the Strategy as a hedged portfolio, as we wanted our stock picking to shine through (when compared with the MSCI EAFE Local Index). However, over the years we have received feedback from investors who liked our approach, but wanted non-dollar-denominated exposure when investing overseas. As a result, we are excited to announce the launch of an unhedged version of the FMI International Strategy (and Fund), which will, with rare exception, own the same stocks as the legacy portfolio, absent the hedging. For more information, please visit www.fmimgt.com.

Thank you for your confidence in Fiduciary Management, Inc.

FMIHX - Top 10 Portfolio Holdings:	
Berkshire Hathaway Inc. Cl B	6.3%
UnitedHealth Group Inc.	5.6%
Masco Corp.	5.0%
Dollar General Corp.	5.0%
JPMorgan Chase & Co.	4.9%
Honeywell International Inc.	4.2%
Quest Diagnostics, Inc.	3.9%
Chubb Ltd.	3.5%
Accenture PLC	3.4%
Omnicom Group Inc.	3.4%

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Fiduciary Management Inc.
International Equity Composite
12/31/2010 - 12/31/2018

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			
2011	-0.78	-1.52	-12.15	1	0.00	n/a	n/a	$ 16.7	$ 12,273.6	0.14%
2012	19.35	18.46	17.31	1	0.00	n/a	n/a	$ 76.3	$ 15,253.5	0.50%
2013	25.89	24.95	26.93	1	0.00	9.78	12.22	$ 165.8	$ 19,705.3	0.84%
2014	5.66	4.87	5.92	1	0.00	7.49	10.33	$ 771.6	$ 21,001.1	3.67%
2015	4.24	3.46	5.33	2	0.00	8.14	11.73	$ 2,832.9	$ 21,042.9	13.46%
2016	11.04	10.23	5.34	3	0.38	7.39	11.53	$ 5,946.2	$ 22,626.7	26.28%
2017	16.51	15.70	15.23	3	0.02	7.04	11.20	$ 8,209.3	$ 25,322.0	32.42%
2018	-8.63	-9.27	-10.99	3	0.06	7.22	9.69	$ 6,287.8	$ 19,833.6	31.70%

*MSCI EAFE Net Local 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 - 12/31/2018. 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 International Equity Composite has been examined for the periods 12/31/2010-12/31/2018. The verification and performance examination reports are available upon request. Benchmark returns are not covered by the report of independent verifiers.

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 $19.8 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 International Equity Composite was created on December 31, 2010. This composite invests mainly in a limited number (usually between 25-40) of large capitalization (namely, companies with more than $5 billion market capitalization) foreign companies.

The International Equity Composite reflects time-weighted and asset-weighted returns for all discretionary accounts. 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, gross of custodial fees, gross of withholding taxes and net of transaction costs. Net of fees returns are calculated net of actual management fees and transaction costs and gross of custodial fees and withholding taxes. Dispersion is calculated using the equal weighted 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®. For the periods 2011-2012, the information is not available for the International Equity Composite.

Currently, the advisory fee structure for the International Equity Composite portfolios is as follows:

Up to $25,000,000	0.70%
$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 $25 million in assets to establish a discretionary account. 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 MSCI EAFE Net Local Index® is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI EAFE Net Local Index consists of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom. It is reported in local currency and net of hedges. The International Equity composite uses the MSCI EAFE Net Local Index® as its primary index comparison.