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INVESTMENT STRATEGY OUTLOOK – INTERNATIONAL EQUITY

December 31, 2020

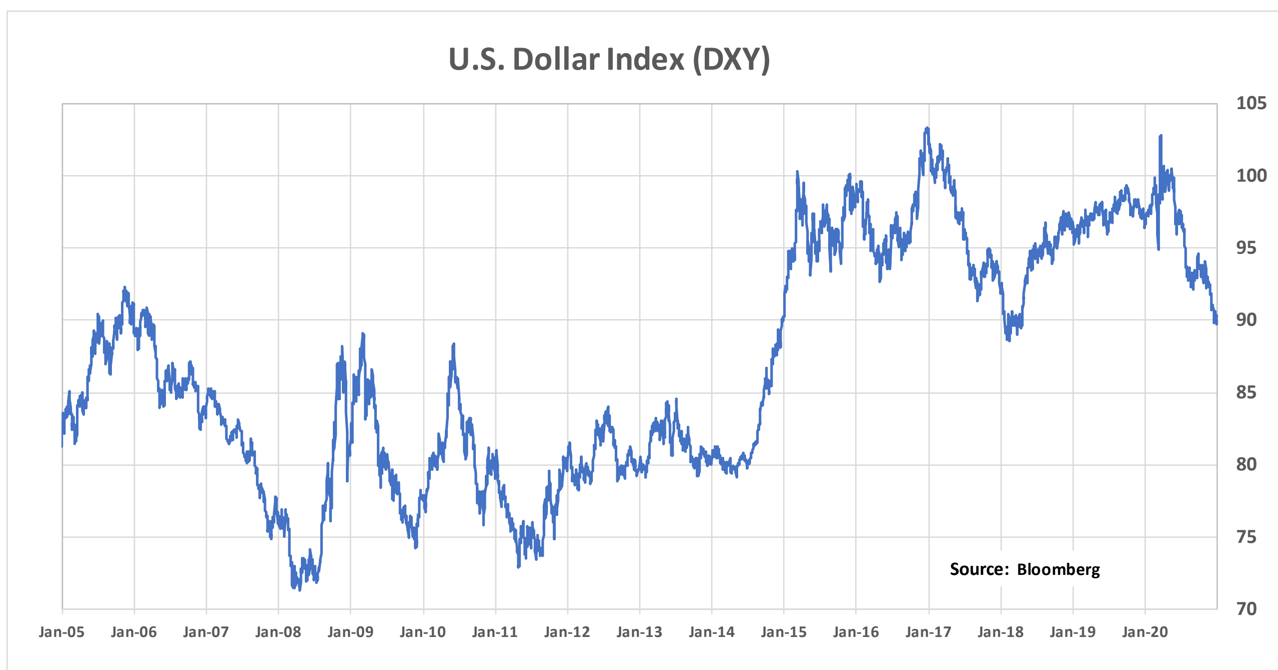
Before we dive into the customary details of the quarter, we are proud to announce that the FMI International strategy has reached the 10-year milestone. Our team has persevered and remains true to our value-driven investment process, generating an attractive risk-adjusted return while successfully navigating a European sovereign debt crisis, an industrial recession, Brexit, a global pandemic, and an unprecedented period of growth outperforming value *by over 65% for the last decade.* In about as challenging of a backdrop as we could have imagined, the FMI International composite (currency hedged) generated a robust annualized return of approximately 8.8%, outpacing the MSCI EAFE Index gain of 6.82% in local currency (LOC) and 5.51% in U.S. Dollars (USD). We also finished well ahead of the MSCI EAFE Value Index, which returned 4.72% in LOC and 3.37% in USD over the same period. Our stock picking landed us in the top decile of both our value and core institutional peers. A decade of strong performance in international markets builds on FMI's distinguished 40-year domestic track record.

While value stocks have been disproportionately hard-hit by COVID-19 this year, they have finally started to show signs of life in the fourth quarter, as promising vaccine news improved the prospects for an economic recovery and sparked a substantial global stock market rally. The FMI International portfolios gained approximately 17.2% (hedged) and 20.8% (currency unhedged) in the period, which compares with the MSCI EAFE Index at 11.35% in LOC and 16.05% in USD. The MSCI EAFE Value Indices increased by 14.28% in LOC and 19.20% in USD, outperforming the comparable MSCI EAFE Growth Indices – the first time since 2018 – picking up over 5.50%. The Electronic Technology, Health Technology, and Consumer Services sectors led the way for the FMI International portfolios, while Consumer Non-Durables, Finance, and Process Industries each detracted. Top individual performers included Samsung Electronics Co. Ltd., Booking Holdings Inc., and Chubb Ltd., as Unilever PLC, Henkel AG & Co., and Shaw Communications Inc. each underperformed. In the shorter term, a weak USD weighed heavily on the hedged portfolio's performance. For the calendar 2020 year, the FMI International portfolios gained 0.06% (hedged) and 3.94% (unhedged).

Since 1980, FMI has strived to own high-quality businesses that are well-run, have solid balance sheets, and trade at a significant discount to intrinsic value. We manage focused portfolios and look to identify durable businesses with sustainable competitive advantages and barriers to entry, and that earn an attractive return on invested capital. We invest when there is a cloud (or controversy) hovering over a company, but one that is temporary in nature and expected to clear. FMI primarily looks for companies domiciled in developed countries, which in most cases have a global footprint, including emerging markets. Market capitalizations will generally exceed $5 billion, our long-term time horizon yields low portfolio turnover, and we offer both a hedged and unhedged vehicle. Valuation is of the utmost importance, with a keen focus on downside protection. Our objective is to generate above-average long-term returns, while taking below-average risk. We have high conviction in our process, which has thrived over many years and business cycles, and we "eat our own cooking," investing right alongside our fellow investors.

To Hedge or Not to Hedge

One factor that shareholders should consider when investing overseas is currency risk. As the world's leading reserve currency, the USD has historically acted as a safe haven during periods of market distress. In 2020, the U.S. Dollar Index (DXY), which measures the value of the USD against a weighted basket of currencies used by U.S. trade partners, strengthened dramatically in March amid the COVID-19 panic, before steadily weakening over the course of the year. By year-end, DXY had fallen 6.69% in aggregate, negatively impacting the FMI International hedged performance. We believe the LOC indices (highlighted earlier) are most comparable for hedged portfolio performance, while the USD indices are most comparable to unhedged portfolio performance. Over the full 10-year period, DXY has appreciated by 13.80% on a cumulative basis, creating a modest tailwind for our hedged portfolio.



At FMI we do not have a house-view on the future direction of the USD; we offer our strategy in both a currency hedged and unhedged version. Our expertise is in stock picking, not predicting currency moves. That said, long-term research suggests that investors should come to expect roughly similar returns from a hedged portfolio (versus unhedged), but with a bit less volatility.

In the near term, the market seems to be forecasting additional weakness in the USD, as articulated by the *The Wall Street Journal (WSJ)*: "The consensus view of a falling dollar is based on a big assumption: COVID-19 will be more or less conquered in the months ahead. Vaccines will allow economies around the world to return to normal within the next year, encouraging investors to step back from the relative safety of U.S. assets and invest in stocks, bonds and currencies outside the U.S."[1] If this prediction comes to fruition, it would bode well for international equities and cyclical value stocks alike (likely benefiting both FMI International portfolios). Alternatively, the USD could be impacted by capital flows, interest rates, relative growth, and inflation, some of which could lead to a stronger USD. Regardless, whether our clients want hedged or unhedged international exposure, we can provide an attractive vehicle for them.

Backdoor Exposure

China populated the headlines often in the fourth quarter, as U.S. and China relations continued to remain strained. In November, the Trump administration prohibited U.S. investments in 31 Chinese companies that were deemed to be owned or controlled by the Chinese military,[2] and in December, the U.S. Commerce Department blacklisted 60 Chinese companies "to protect U.S. national security," which included Semiconductor Manufacturing International Corporation (SMIC), China's biggest semiconductor chip maker.[3]

To date, FMI has not made direct investments in mainland China. We are not willing to compromise our process, and thus, will only invest in countries and companies where we can conduct our standard level of due diligence. We do not feel comfortable investing our clients' money in a country with a weak rule of law, poor levels of disclosure, a lack of management trust, questionable accounting practices and governance, and a host of other issues. While this may change over time, today, our exposure to China and a number of other emerging markets has come predominantly through the

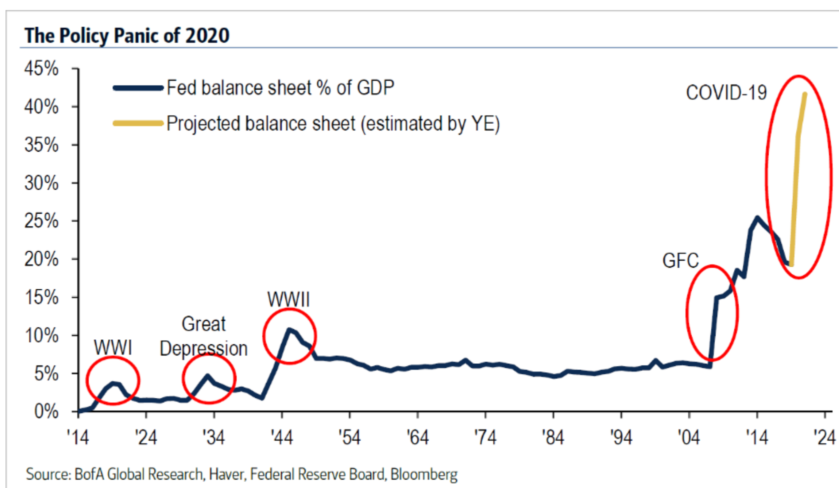
[1] Paul Davies. "The Dollar Is Weak. Investors Bet It Will Slide Even More." *The Wall Street Journal*, November 26, 2020.
[2] Humeyra Pamuk, Alexandra Alper, and Idrees Ali. "Trump bans U.S. investments in companies linked to Chinese military." *Reuters*, November 13, 2020.
[3] "U.S. Blacklists More Than 60 Chinese Firms, Including SMIC." *Bloomberg News*, December 17, 2020.

geographic footprint of our developed market businesses. Currently, over 25% of our companies' revenue is generated in emerging markets.

A recent in-depth article by the *WSJ* epitomizes our governance concerns in China: "[President] Xi Jinping, long distrustful of the private sector, is moving assertively to bring it to heel. China's most powerful leader in a generation wants even greater state control in the world's second-largest economy, with private firms of all sizes expected to fall in line. The government is installing more Communist Party officials inside private firms, starving some of credit and demanding executives tailor their businesses to achieve state goals. In some cases, it is taking charge entirely of companies it regards as undisciplined, absorbing them into state-owned enterprises. […] In September, the party issued new guidelines for private companies, reminding them to serve the state and vowing to use education and other tools to 'continuously enhance the political consensus of private business people under the leadership of the party.'"[4] A series of recent defaults by state-owned enterprises, several of which previously had Triple-A credit ratings,[5] does not instill any additional confidence. To us, the reward is not currently worth the risk.

An Unsustainable Path Forward

We continue to marvel at the magnitude of global central bank and government actions, and their distortive impact on price discovery. In the past nine months alone, an astounding $22 trillion of fiscal and monetary stimulus has been announced worldwide, and central banks have spent $1 trillion per month on financial asset purchases (a.k.a. quantitative easing, or QE), "crushing yields, volatility, and spreads, successfully inciting asset price inflation," according to Bank of America.[6] Debt has grown at an unprecedented pace, per the Institute of International Finance, with global debt levels rising $52 trillion from 2016-20, which compares with a $6 trillion increase from 2012-16. Total debt is expected to increase by $15 trillion this year alone, with global debt on track to exceed a staggering $277 trillion by year end, or 365% of GDP (from 320% at the end of 2019). Debt in advanced economies will rise by more than 50 percentage points to 432% of GDP.[7] These numbers are mind-boggling.



Growth stock returns are heavily dependent on an interest rate environment that appears unsustainable, and there is no historical precedent for today's exceptionally low cost of capital. Money shouldn't be free (or worse, have a *negative yield*). Investors are typically compensated for taking on risk, not paying for the privilege. Remarkably, negative-yielding bonds reached another new record in the fourth quarter: $18.4 trillion, accounting for over 27% of the world's investment grade debt.[8] Real yields (adjusted for inflation) are negative for $31 trillion of government bonds, or 76% of the sovereign debt market (versus 57% three years ago), per JPMorgan.[9] We do not believe policy makers can just print money hand-over-fist, blow out huge budget deficits, and take on mountains of debt without serious long-term implications. Eventually, inflation and higher rates will come roaring back, especially if we get faster economic growth.

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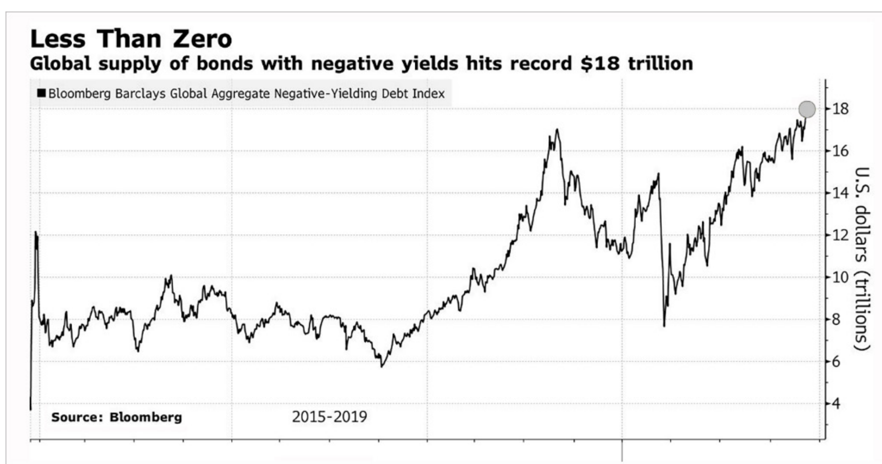
[4] Lingling Wei. "China's Xi Ramps Up Control of Private Sector. 'We Have No Choice but to Follow the Party.'" *The Wall Street Journal*, December 10, 2020.
[5] "How the Sausage is Made." *Almost Daily Grant's*, December 8, 2020.
[6] Michael Hartnett, David Jones, and Shirley Wu. "The Flow Show: Quiz Show." *BofA Global Research*, December 17, 2020.
[7] Jonathan Wheatley. "Pandemic fuels global 'debt tsunami.'" *Financial Times*, November 18, 2020.
[8] Cormac Mullen and John Ainger. "World's Negative-Yielding Debt Pile Hits $18 Trillion Record." *Bloomberg*, December 10, 2020.
[9] Anchalee Worrachate. "JPMorgan Says Real Yields Are Negative for $31 Trillion of Bonds." *Bloomberg News Wire*, October 8, 2020.

The eventual fallout could include increased borrowing costs (potentially causing a credit crisis), higher discount rates (weighing more heavily on growth stocks than value stocks), and reduced purchasing power, among others.



Proponents of these experimental policies point to Japan as the model for success, which is disconcerting. Though interest rates have remained low in Japan (while the domestic population has agreed to financial repression), what else have they achieved? Japan's GDP growth continues to lag other developed economies; it is currently the most indebted country in the world and its stock market is far lower in 2020 than it was in 1989. If rates were to rise unexpectedly, it could create a nightmare scenario for Japan's budget deficit and the holders of Japanese government debt. We believe these monetary policies have failed for years in Japan (and elsewhere) and could end miserably for everyone trying to emulate them.

<u>Holding Update: CK Hutchison Holdings Ltd. (1 HK)</u>

While easy money has driven a lot of growth stocks to the moon, many value stocks continue to be stuck in the mud. In our March 31, 2020 letter, we featured CK Hutchison Holdings (CKH), a blue-chip holding company that owns relatively defensive, high-quality businesses (telecom, infrastructure, retail, etc.). The company has taken steps to unlock value in recent months, yet the stock price has barely budged. In November, CKH announced a favorable sale-and-leaseback of its European tower assets for €10 billion, equivalent to 43% of its market cap (while giving up ~5% of consolidated EBITDA).[10] In addition, the company's energy segment (~3% of normalized earnings from an equity investment in Husky Energy), which had been a drag on its sentiment in recent years, is soon to be deconsolidated. Husky is merging with Cenovus, which reduces CK Hutchison's ownership of the combined entity to around 16%. These recent transactions demonstrate management's willingness to take action to create shareholder value. Despite a strong balance sheet, based on our estimates, the stock trades at a over a 60% discount to net asset value, which is more than a two standard deviation departure from its historical level. On 2021 estimated earnings, the stock trades at only ~6 times, and pays a healthy 5.1% dividend. Insiders have purchased $34 million of stock over the past couple years, and we share their enthusiasm, as we have also been adding to our position size. In our assessment, the current stock price severely undervalues the business.

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As we reflect on the last 10 years, we are proud to stand behind FMI International's performance, especially given the recent, unparalleled momentum-driven backdrop. We are confident that value investing will once again return to prominence, and until then, we will remain diligent and patient, looking for opportunities to improve the portfolio one stock at a time.

Our sincere thanks for your support of the FMI International strategy.

[10] Earnings before interest, taxes, depreciation and amortization

Fiduciary Management Inc.
International Equity Hedged Composite
12/31/2010 - 12/31/2019

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%
2019	18.11	17.29	21.67	3	0.08	8.30	9.48	$ 7,522.0	$ 22,609.8	33.27%

*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 - 12/31/2019. 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 12/31/2010-12/31/2019. 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 $22.6 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,

Fiduciary Management Inc.
International Equity Unhedged Composite
12/31/2019 - 09/30/2020

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			
Q1 2020	-29.09	-29.22	-20.55	1	0.00	n/a	n/a	$ 26.5	$ 15,121.8	0.17%
Q2 2020	14.54	14.32	12.60	1	0.00	n/a	n/a	$ 31.7	$ 15,293.9	0.21%
Q3 2020	6.86	6.66	1.22	1	0.00	n/a	n/a	$ 47.5	$ 14,993.2	0.32%

*MSCI EAFE Net Index (USD)®

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Up to $25,000,000	0.70%
$25,000,001-$50,000,000	0.65%
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