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INVESTMENT STRATEGY OUTLOOK - INTERNATIONAL EQUITY

Global economic growth continues to recover from the COVID pandemic, although it has been slowed by the spread of the Delta variant. The reopening process has been impacted, weighing on manufacturing, trade, consumer spending, and business sentiment, among other areas. The current backdrop has led to a rotation right back into growth stocks, which have outperformed their value counterparts by around 7% since mid-May, an unfortunate development given our value orientation.

During the September quarter, the FMI International portfolios declined approximately 1.0% (currency hedged) and 2.8% (currency unhedged), compared with an MSCI EAFE Index gain of 1.32% in local currency (LOC) and fall of 0.45% in U.S. Dollars (USD). The MSCI EAFE Value Index added 0.82% in LOC and fell 0.97% in USD, trailing the MSCI EAFE Growth Indices by about 1% during the period. The Consumer Services, Consumer Durables, and Utilities sectors were relative contributors for the FMI International portfolios, while Health Technology, Producer Manufacturing, and Electronic Technology lagged. Top individual performers were Vivendi, Sony Group Corp., and Yokogawa Electric Corp., as Smith & Nephew PLC, CK Hutchison Holdings Ltd., and Fresenius Medical Care AG & Co. KGaA underperformed. A strong USD boosted FMI's currency hedged performance.

Overall, we are optimistic about the long-term global economic outlook. COVID-19 should eventually exhaust itself through a combination of vaccination and infection, and a return to normal business activities ought to ensue. However, uncertainty is heightened in the near term, which may lead to additional bumps in the road.

Inflation & Labor Shortages: Not Just a U.S. Problem

Inflation is rising in many countries around the world as economies rebound but are faced with increasing wages, shelter costs, energy and commodity prices, transportation expenses, and supply chain constraints. Shortages of semiconductors and other important manufacturing components are also contributing to higher prices. Unprecedented stimulus has added fuel to the fire, as global central banks continue to print money relentlessly. Although some of these factors will prove transitory in nature, we find ourselves among the minority of investors who believe higher inflation will be here to stay.

While the U.S. is facing consumer price inflation of over 5% (year-over-year), Eurozone inflation has risen to its highest level in nearly a decade, hitting a headline rate of 3% in August, well above the European Central Bank's (ECB) target of 2%.[1] Similarly, UK consumer prices rose 3.2% in August, up from 2% in July. This is the largest month-over-month increase since records began in January of 1997.[2] The European Union (EU) has been facing worker shortages driven by "the disruption of intra-EU mobility and migration flows, by workers switching sectors during the pandemic, and by workers' reluctance to take up jobs in certain sectors because of concerns over wages and working conditions," according to Eurofound.[3] Brexit is also a factor, as it has created additional barriers for the movement of labor between the UK and EU.

Meanwhile in China, producer price inflation rose 9.5% in August, a 13-year high.[4] Material costs and labor shortages have soared. The Wall Street Journal (WSJ) reports that "with global demand for Chinese goods surging this year, factory owners say they are struggling to fill jobs that make everything from handbags to cosmetics." Weak demographics, including a shrinking and aging labor pool, continue to be structural headwinds. "China's working age population, defined as people between 15 and 59, fell to 894 million last year, or 63% of the total population. That was down from 939 million in 2010, or 70% of total population at the time, according to the country's once-in-a-decade census data. China's workforce is expected to drop by about 35 million over the next five years, according to official estimates," per the WSJ. Furthermore, young workers are opting for less physically demanding or better paying service-industry jobs.[5] It will take higher compensation to attract much-needed workers back into the manufacturing sector.

This dynamic has the potential to create significant global inflationary pressures. The world has become hooked on cheap Chinese imports, and China's exporters are now raising prices for the goods they sell abroad. Low-cost labor in China was the driving force for keeping prices low across a host of product categories. To make matters worse, shipping costs from China have also risen dramatically, due in part to port bottlenecks and container shortages, as illustrated in the chart on the following page.

While freight expenses should eventually normalize, rising wages may be stickier and harder to dial back. Layer in the fact that global money supply has grown much faster than output (courtesy of $32 trillion of fiscal and monetary stimulus in 2020-21),[6] and it may be difficult to put the inflation genie back in the bottle. As outlined in our June letter, we believe the FMI International portfolios are well-positioned for higher inflation and interest rates, should they become a lasting reality.

China: Self-Inflicted Wounds

Unfortunately, China's businesses appear to have other pressing issues on their hands. The Chinese government has aggressively cracked down on the private sector, sending ripples across e-commerce, financial technology, for-profit education, ride-sharing, and real estate development, to name a few. The government

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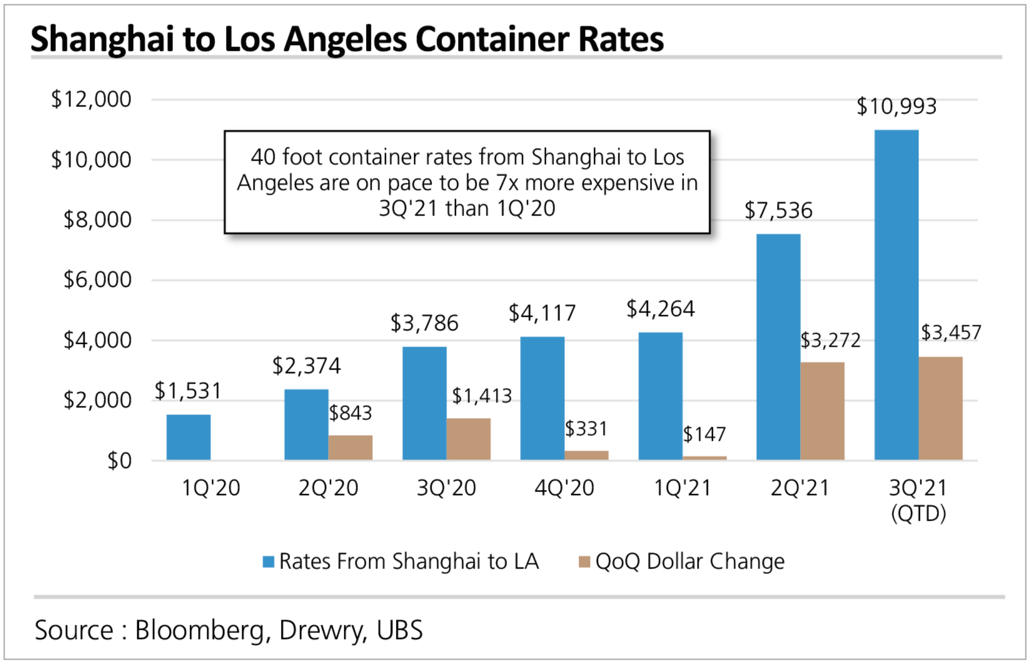
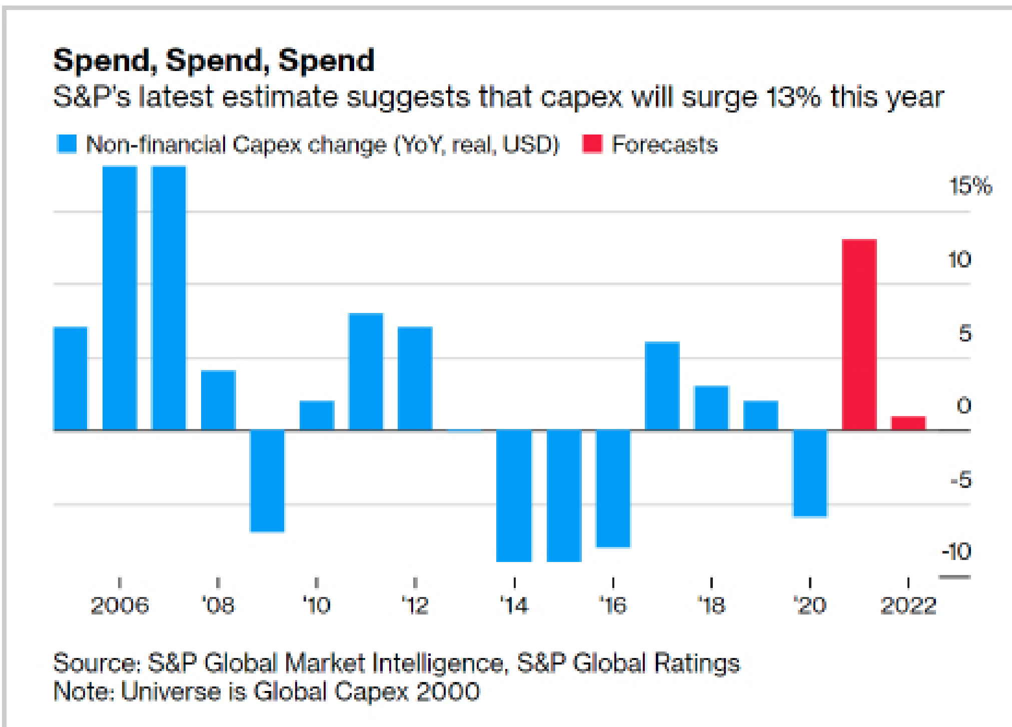
[1] Martin Arnold. "Decade-high eurozone inflation raises heat on ECB to cut stimulus." *Financial Times*, August 31, 2021.
[2] Matt Clinch. "UK inflation rate posts biggest increase since records began." *Reuters*, September 15, 2021.
[3] Tina Weber and Dragos Adascalitei. "The pandemic aggravated labour shortages in some sectors; the problem is now emerging in others." *Eurofound*, July 20, 2021.
[4] "China's factory inflation hits 13-year high as materials costs soar." *Reuters*, September 9, 2021.
[5] Stella Yifan Xie and Liyan Qi. "Chinese Factories Are Having Labor Pains—'We Can Hardly Find Any Workers'." *The Wall Street Journal*, August 25, 2021.
[6] Michael Hartnett, David Jones, Shirley Wu, and Myung-Jee Jung. "The Flow Show: Reconciliation, taxation & stagflation." *BofA Global Research*, September 9, 2021.

blocked the highly anticipated IPO of Alibaba Group Holding Ltd. affiliate Ant Group Co. Ltd.; turned the country's $120 billion private tutoring sector into a non-profit; hit Alibaba and Tencent Holdings Ltd. with big fines; initiated a cybersecurity review of ride-share company DiDi Global Inc. while ordering the removal of the company's app from online stores; limited the amount of time children are allowed to play online video games; and capped borrowing for indebted property developers. The WSJ reports that many believe the government is "just getting started in its push to realign the relationship between private business and the state, with a goal of ensuring companies do more to serve the Communist Party's economic, social and national-security concerns."[7]





Investors have clearly taken notice. From a February high, China's top six technology stocks have lost nearly $1 trillion in market cap, while the NASDAQ Golden Dragon China Index, which consists of Chinese companies publicly traded in the U.S., is down approximately 50%. China Evergrande Group, one of China's largest property developers, is on the brink of collapse, with deteriorating cash flows and more than $300 billion in liabilities. The consensus view is that Evergrande is not China's "Lehman Brothers moment," as the fallout is likely to be contained by government intervention. That said, fears of "contagion" appear justified, with real estate alone accounting for a significant portion of the country's GDP (14% direct, or upwards of 25% when factoring in indirect activity).[8] Furthermore, the Chinese economy has taken on an enormous amount of debt in recent years (in part due to the property boom), and high leverage always increases the risk profile. Additional dominoes may be poised to fall.

As we have explained in prior letters, we have refrained from investing directly in mainland China. To date, we have not been able to get comfortable with the authoritarian government, rule of law, poor levels of disclosure, management distrust, accounting practices, and subpar corporate governance. While this stance may change over time, as we continue to evaluate the state of affairs, recent data points (described above) do not instill confidence. For the time being we will continue to watch from the sidelines.

To Build or to Buy

On a more positive note, world capital expenditure (capex) is on the rise and broad-based across geographic regions and business sectors. Global investment is projected to increase 13% this year

[7] Jing Yang, Keith Zhai, and Quentin Webb. "China's Corporate Crackdown Is Just Getting Started. Signs Point to More Tumult Ahead." *The Wall Street Journal,* August 5, 2021.
[8] David Rosenberg. "Breakfast with Dave." *Rosenberg Research*, September 20, 2021.

according to S&P Global Ratings, with particular strength in semiconductors, retail, software, and transportation. Morgan Stanley economists expect global capex to reach 115% and 121% of pre-recession levels by the end of 2021 and 2022, respectively. This would be a strong showing when compared with previous downturns. Following the 2008-09 financial crisis, for example, weak investment lasted for a number of years, dragging growth, productivity, employment, and wages down with it.[9]

For much of the subsequent period, corporations have been obsessed with mergers and acquisitions (M&A), in lieu of organic business investment. Ultra-low interest rates have played no small part. Even today, we are on pace to set a record for global M&A activity in 2021, with nearly $4 trillion spent year-to-date (up from $2.6 trillion in 2019).[10] However, we do not believe acquisitions at nosebleed valuations are an effective way to grow an economy, and would much prefer to see companies focus their efforts inward.

M&A activity should start to cool once interest rates normalize, which could go a long way toward improving future growth prospects. Fortunately, the Federal Reserve and ECB appear to be slowly inching toward tapering their quantitative easing programs, an important first step. The sooner they take away the proverbial "punch bowl" the better!

<u>**Temporary Clouds: Acute COVID Pressure**</u>

As a result of the Delta variant's emergence, we have suffered idiosyncratic moves in several of our holdings, outlined below. While the businesses face near-term fundamental pressures, the long-term investment opportunities remain attractive:

Fresenius Medical Care AG & Co. KGaA (FME GR) is the number one global provider of life-saving products and services for patients with chronic kidney failure and end-stage renal disease (ESRD). As morbid as it may sound, COVID-19 has led to significant "excess mortality" in their patient base. This has pushed growth out into the future. A decline toward very little excess mortality is inevitable (likely sometime in 2022). At that point, the company's dialysis services patient base should stabilize and return to unit growth, and international penetration should resume. Growing patients means more non-acute treatments (three times per week), and more razor-and-blade sales for the company's leading dialysis equipment business and integrated downstream businesses (including pharmacy). The company should then be able to rightsize its cost structure and continue making progress on its strategic initiatives. Ultimately, ESRD patients should grow mid-single-digits globally and at least low-single-digits in North America due to long-term trends in diabetes, obesity, and other lifestyle factors. The stock is trading at around 15 times depressed earnings, and being held down by a temporary cloud that should eventually clear.

Smith & Nephew PLC (SN/ LN) is a leading global medical technology company focused on joint repair, reconstruction, and replacement, as well as wound management. Around 70% of the company's products are used in procedures that can be deemed "elective" (deferrable, but not indefinitely). During 2020, many procedures were postponed due to COVID-19. In the most recent quarter, product demand was above 2019 levels, but the near-term outlook became constrained by increasing procedure deferrals in Japan, Australia, and parts of Asia. This, when combined with other temporary factors (higher research and development expenses, foreign exchange headwinds, and rising shipping costs), led to a selloff in the stock. Meanwhile, pent-up demand continues to build; bad hips and knees have not gone away, but have instead gotten worse, while sports have largely resumed. With upgraded management, rising new product vitality, and solid overall growth drivers, the company should grow the top line in the mid-single-digits during normal times, while continuing to slowly chip away at a 500+ basis point margin gap versus peers. The stock trades at a significant discount to the market and its competitors, which we do not believe is warranted.

Safran S.A. (SAF FP) is a French manufacturer of aerospace propulsion and equipment systems. Its narrowbody engine franchise is one of the best aerospace assets in the world. We believe that people will slowly return to traveling as COVID-19 dissipates, just as they have after every other demand shock. There is early evidence of this in countries with high vaccination rates. The company was handily profitable and generated positive free cash flow during 2020, the worst year in aviation history. The balance sheet is in great shape and we believe margins will be structurally higher post-COVID. The shares recently sold off due to concerns around the Delta variant's impact on travel. Notwithstanding this near-term blip, we believe the earnings and valuation multiples could surpass pre-COVID levels within the next three years, providing 50%+ of upside potential.

Despite a challenging backdrop that has been difficult for fundamental, value-orientated investors, we continue to stay the course. We are hired by our clients to deliver attractive risk-adjusted returns. Today, investors are focused on returns, with little care for the risk side of the equation. Factors of great importance to FMI (business quality, balance sheet strength, downside protection and valuations) have seemingly become an afterthought in today's speculative-driven stock market. While the current market dynamics have gone on a lot longer than we expected, we do believe that the cycle will inevitably turn. Until then, the team continues to increase our investment in the portfolios right alongside our shareholders.

Outlined on the following pages are a couple of additional investments where we have recently found value.

[9] Enda Curran. "Capex Booms as Companies Prepare for a Post-Pandemic World." *Bloomberg*, September 11, 2021.
[10] James Fontanella-Khan. "M&A on track to break records after $4tn of deals so far this year." *Financial Times*, September 5, 2021.

Rexel S.A. (RXL FP)

(Analyst: Andy Ramer)

Description

Rexel is a leading global distributor of low and ultra-low voltage electrical products to professional customers, with sales of €12.6 billion in 2020. The company serves the needs of a large variety of customers, with 650,000 active customers in commercial (43% of sales), industrial (29%), and residential (28%) end markets through 1,900 branches. The product offering of over two million active stock-keeping units covers Electrical Installation Equipment (44%), Cables & Conduits (22%), Lighting (15%), Climate Control (6%), Tools (4%), Software & Specific Services (3%), Renewable Energies & Energy Management (3%), Security & Communication (2%), and White & Brown Goods (1%). The geographic mix consists of Europe (56% of sales, 66% of profit), North America (35%, 30%), and Asia-Pacific (9%, 4%).

Good Business

- Rexel is a key value-added partner for suppliers and customers. The company's service-oriented business model helps support its industry-leading position in a large and fragmented market. Rexel's differentiating qualities include its technical expertise, intensity of customer training, growing omnichannel presence, and increasing support for decision-making. These factors are critical given the bespoke installation nature of the products.
- The company distributes critical products that help manage power more reliably, safely, and sustainably. Order frequency is high, as on average, most customers place an order every other day. Within the commercial area, approximately 50% to 60% of the European market and 30% of the U.S. market is retrofit.
- Return on invested capital (ROIC) excluding goodwill was in the mid-teens at the cycle bottom in 2020 (mid-twenties on tangible capital) and the outlook for return on incremental invested capital is attractive, driven by organic growth, margin expansion, tight management of working capital, and low capital intensity of the business.
- This is an easy business to understand.
- Net debt is at the lowest level since the 2007 IPO. The leverage ratio of 1.8 times is an appropriate level for a distributor, given the countercyclical characteristics of the business model. The business is highly free cash-generative and cash conversion should improve further with capex and working capital levels now stable following a period of investment.

Valuation

- Rexel is being valued at 10.5 times 2021 estimated earnings per share.
- Enterprise value-to-2021 estimated earnings before interest and tax multiple (EBIT) is 9 times.
- 2021 estimated free cash flow yield value is 7%.

Management

- Activist investor Cevian Capital AB owns 20% of Rexel, has a representative on the company's board of directors, and instituted new governance and management in mid-2016. The company's performance has since improved markedly, and it is focused on profitable growth and value creation.
- Ian Meakins has served as Chairman since July 2016. He is credited with turning Ferguson around (while CEO of Wolseley) from July 2009 to August 2016. Under his stewardship, Wolseley was able to significantly improve Ferguson's profitability by focusing the organization on regional leadership positions, high customer service, and pricing management.
- Guillaume Texier succeeded Patrick Berard as CEO in September 2021. Mr. Berard, who was in his final term as CEO, repaired the company, deleveraged the balance sheet, refocused it on customers, made it more agile, and invested heavily in its digital transformation. Berard will remain at Rexel until March 2022 to ensure a smooth transition. Texier had a distinguished career at Compagnie de Saint-Gobain and his skillset is well-suited for Rexel.
- Compensation is tied to growth in organic sales, margins, EBITA,[11] working capital, free cash flow, and digital sales.

Investment Thesis

Rexel has done most of the heavy lifting on the turnaround and investments and has entered the execution phase. The company is well-positioned to benefit from the positive structural trends in its industry, such as growth in electricity consumption, increased energy efficiency and reduction in emissions, and growth in the number of connected devices, as well as share gains from small and mid-sized players who do not have the wherewithal to invest into digital transformation. Annual organic sales growth of 3-4% would translate into EBIT growth of 11-12% per annum, which when combined with a dividend yielding nearly 3.0% and the potential for multiple expansion, offers an attractive total return opportunity.

[11] Earnings before interest, taxes, and amortization.

NOF Corp. (4403 JP)

(Analyst: Matt Sullivan)

Description

NOF Corporation is a Japanese specialty chemicals company headquartered in Tokyo that primarily sells into cosmetics and toiletries, life sciences, auto, and HVAC end markets. Approximately 70% of the company's sales come from Japan and 30% elsewhere. NOF reports in three main business segments: Functional Chemicals (64% of sales, 56% of operating profit), Life Sciences (18%, 37%), and Other (18%, 7%). The company's origins trace back to 1921.

Good Business

- The company earns an attractive 20% ROIC, excluding net cash and investments on the balance sheet.
- Products require years of research and development, and many are tailored to meet customer needs. Once they get specified into an end product, switching costs disincentivize change.
- NOF's products are a small part of customers' costs, but are important and value-additive to their end products; many of the products are consumed, and therefore, the business exhibits recurring revenue characteristics.
- NOF operates in niche, growing markets where competition is often limited, and it has a broad product lineup sold into a number of different end markets.
- The company's products are necessary, the business is easy to understand, and its balance sheet is strong with net cash.

Valuation

- The stock is trading at approximately 17 times our next 12-month earnings per share estimate, excluding net cash and investments on the balance sheet. We believe this is an attractive valuation, given the company's growth prospects and return profile.
- The company's fundamentals continue to be resilient throughout the Coronavirus pandemic, which we believe justifies an expanded multiple.

Management

- Takeo Miyaji has been CEO since June 2018, and has also worked at the company in a number of different management positions since 1980.
- Akiharu Kobayashi has been Chairman since June 2018. Previously, he was CEO from June 2012 to June 2018, and has worked with the company since April 1979 in numerous management positions.
- The management team is focused on organic sales growth and expanding operating margins, and has demonstrated that they care about shareholder returns. In addition to paying a dividend, they've also returned cash through consistent share repurchases over time. This is unique behavior relative to most Japanese companies we have observed.

Investment Thesis

NOF is a high-quality business that generates a strong ROIC, emphasizes organic profit growth, and has a fortress net cash balance sheet. We believe that over the next several years, the company has the ability to compound sales at a mid-single-digit annual rate, and profits at an upper-single-digit annual rate. After factoring in share repurchases and the company's 1.2% dividend yield, investors have the potential to earn a low-double-digit to low-teens annual return from the stock without multiple expansion. Given the growth expectations, the return profile, and the stability the business has displayed throughout the pandemic, we believe the stock is trading at an attractive valuation.

Thank you for your continued support of Fiduciary Management, Inc.

Fiduciary Management Inc.
International Equity Hedged Composite
12/31/2010 - 12/31/2020

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 %
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	$ 22,609.9	33.27%
2020	0.98	0.25	0.84	3	0.27	17.52	15.65	$ 3,576.9	$ 16,284.2	21.97%

*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, Inc. claims compliance with the Global investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Fiduciary Management, Inc. has been independently verified for the periods 12/31/1993 - 12/31/2020. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. The International Equity Hedged Composite has had a performance examination for the periods 12/31/2010 - 12/31/2020. The verification and performance examination reports are available upon request. As of January 1, 2021 the International Equity Composite was renamed the International Equtiy Hedged Composite.

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 $16.2 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 International Equity Hedged Composite was created and incepted on 12/31/2010. 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 Hedged 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®. FMI uses gross returns to calculate these.

Currently, the advisory fee structure for the International Equity Hedged 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 and FMI distributed mutual funds are 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 Hedged composite uses the MSCI EAFE Net Local Index® as its primary index comparison.

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

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			
2020	4.88	4.09	7.82	1	0.00	n/a	n/a	$ 56.7	$ 16,284.2	0.35%

*MSCI EAFE Net Index (USD)®

Returns reflect the reinvestment of dividends and other earnings.
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$25,000,001-$50,000,000	0.65%
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