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INVESTMENT STRATEGY OUTLOOK - LARGE CAP EQUITY

Quarter Ended June 30, 2005

In the June quarter, client portfolios were generally down slightly on an absolute basis, trailing the benchmark Standard & Poor's 500. The portfolio gained slightly calendar year-to-date, compared to a decline of 0.8% in the S&P 500. Although the quarter benefited from both a rebound in Kroger and continued strong performance in the Energy area, a number of stocks had a difficult quarter. Lingering worries about insurance pricing and finite insurance contracts hurt Willis and the General Re division of Berkshire Hathaway, respectively. Fears of a slowing economy negatively affected W.W. Grainger as well as our Retail stocks. Our underweighted position in Financial stocks hurt us in the quarter, as this area was quite strong. In short, it wasn't a particularly good quarter.

Fortunately, one quarter, or even a year's performance is relatively meaningless for long-term investors. As long as we continue to own good, durable businesses at reasonable valuations, the three- to five-year outlook will be attractive. We remain confident in the fundamental prospects of the companies in the portfolio. While generally not flashy, the companies in which FMI invests typically lead their respective niches, provide necessary products and services, are well financed, and trade at a meaningful discount to the market. Currently, the FMI portfolio trades for approximately 1.3 times annual revenue (market capitalization divided by annual revenue), which compares to approximately 2.6 times for the S&P 500. The EV/EBITDA ratio (market value plus net debt divided by earnings before interest, taxes, depreciation and amortization) for the portfolio is 7.8 compared to the S&P 500's ratio of 11.6. Our balance sheets are strong, and as long as the market doesn't enter a period of significant speculative excess, we remain optimistic that the portfolio will do relatively well.

Below are some general thoughts on the economy and our outlook.

Economic Growth

The U.S. economy (GDP) grew at a 3.8% real rate in the first quarter. According to the official statistics, that was the eighth straight quarter in excess of 3%. The "consensus" estimate for real GDP growth in the second quarter is 3.1%. This growth has come as a surprise to many, given the numerous challenges that have been articulated in the media. Specifically, higher short-term interest rates, escalating energy prices, a "tapped-out" consumer, uneven employment gains and large trade deficits have all taken their turn as the headline worry. Despite real concerns on all of these subjects, the economy advanced very respectably in the first half of the year. Why? In an economy as large, diverse and complex as ours, it would be folly to think we had *the* answer. We are confident that we understand one source of the strength behind these numbers: cash out refinancing and home equity lines of credit. Consumers are estimated to have pulled over $500 billion of equity out of their homes over the past year. It is highly likely that most of this money was plowed back into the economy, aiding reported GDP growth. Furthermore, stronger residential fixed investment was a significant driver of growth in the first half of the year.

It is difficult to envision home building and the recycling of home equity as reliable sources of future growth. Already there are signs of exhaustion in this market. The explosion of "interest only" and other adjustable mortgages suggests that traditional (credit worthy?) customers have been sated. Regulators have also begun clamping down on some of the more exotic lending practices. Putting aside increased mortgage debt as a source of cash, there is the notion that consumers could shoulder even more traditional credit card or installment debt. Indeed, that phenomenon has been a major source of funds in recent years. But consumers have outspent their incomes for a number of years and today, consumer debt and the debt service burden remain extremely high by historical standards. It is just hard to imagine the consumer continuing to operate in this fashion for many more years. Future growth is likely to come the old fashioned way, through employment and wage gains.

The U.S. economy should be helped somewhat in future years by better economic performance in the rest of the world. With the exception of China, most of Asia has been subpar since the 1998 "Asian Contagion." Free markets are developing all over the world, and that bodes well for the U.S. over the long run. In the near term, however, economic growth depends on American consumers staying confident and spending all or more of their incomes. Barring a significant decline in housing prices and the damage that would wrought on consumer confidence, we see reasonable economic growth in coming quarters. Ultimately, we believe adjustments will have to take place that may result in lower economic growth for awhile. How painful this will be depends on a large number of factors that are hard to predict and which are really beyond the scope of this letter.

Interest Rates/Monetary Policy

The yield curve has flattened fairly dramatically this year (see table below), with the 10-Year Treasury dipping below 4%. At quarter end, there was only a 28 basis point spread between the 2-Year and 10-Year Treasury. The bond market is seeing an economic slowdown, while Greenspan recently completed the ninth quarter point "measured" hike in the past year in an effort to achieve "neutrality." The failure of the long end of the curve to rise in the face of these rate hikes has resulted in Greenspan's ignominious "conundrum." Perhaps it would be instructive to back up a bit and put this conundrum into perspective. Of course, perspective is colored by whether or not one is a Greenspan partisan. A fan of the man affectionately known as The Maestro would say he navigated the aftermath of the stock market bubble by injecting liquidity into the system, skirting deflation, and helping to bring the economy out of its malaise into a steady rate of growth. On the other side of the coin are those that see the Fed's loose policies in the late 1990s aiding and abetting the stock market bubble in the first place. They see Greenspan capitulating to the "New Era" doctrine of technology-induced productivity gains for as far as the eye could see. Furthermore, rather than letting market forces work through a natural adjustment process after the bubble burst — which would have resulted in many liquidations and reduced capacity, perhaps even a deeper recession (and the reloading of consumer balance sheets) — the Fed drove short term interest rates to 1%. This pain avoidance policy response in any other age would signal an emergency. In this age, it was a green light for the creation of a different kind

Historical U.S. Treasury Yield Curve

Maturity	12/31/04	06/30/05	Change
3-months	2.21	3.12	0.91
2-years	3.07	3.63	0.56
3-years	3.22	3.64	0.42
5-years	3.61	3.70	0.09
10-years	4.22	3.91	-0.31
30-years	4.83	4.19	-0.64

of asset bubble — housing — and an explosion of speculative activity in the form of junk bonds, derivatives, and trading-oriented hedge funds.

Greenspan knows now that his accommodative rate policy fostered extraordinary speculation. The Fed has been inching rates up, in order to help quell this speculation and address some concerns about inflation. The bond market hasn't cooperated, however, because it sees economic weakness on the horizon. Thus, the long end of the curve has been going down, not up. Mortgages and many other forms of credit are tied to long rates; as such, housing speculation and credit derivatives, for example, remain in an unabated growth mode. Thus, we have a conundrum.

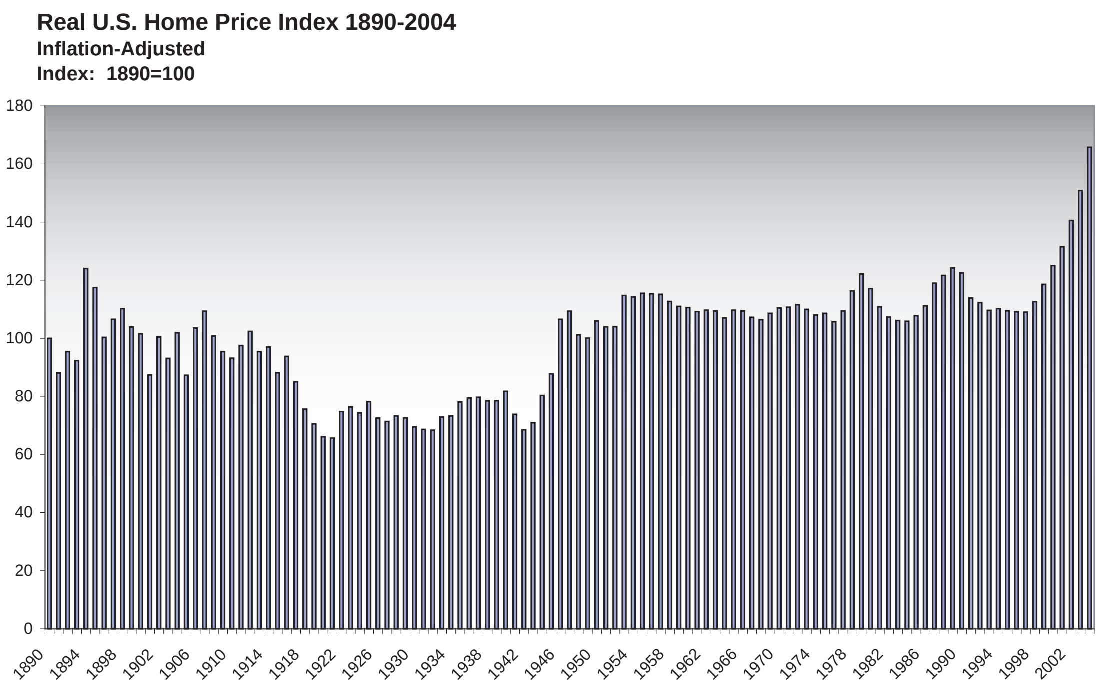
Housing

We have talked about housing a couple of times over the past year and we hesitate to give it much more air time, only because "the housing bubble" has been so thoroughly discussed in the media in recent months. Given the contrarian blood that runs through our veins, we would almost view this media coverage as a counter indicator. Almost. We have already discussed the fact that the rate environment continues to encourage housing speculation, so perhaps a tough housing market is still a ways away. Anecdotally, however, the stories of excess abound. There are 170 chapters of the Real Estate Investors Association today, up from 22 in 2002. Speculators are a rapidly increasing percentage of homebuyers. The National Association of Realtors released a study in March estimating that investors, sometimes known as speculators, represented 23% of home purchases. Some of the speculators remind us of the stock day traders in the late 1990s. We read recently about a fellow driving around Phoenix, lost, trying to find one of the six houses he owns there. He also has a half share in seven other Phoenix homes. He lives in Las Vegas, where the 2002-2004 increase in home prices was 66.7% — but he plies the greater Phoenix market because Las Vegas has started to cool. He is 22 years old.

Nearly everyone reading this letter knows of someone who has "made a killing," in real estate — with no money down! Just looking out the window on the drive home causes us to scratch our collective heads. Who is buying all these new homes? Here in Milwaukee there is a housing boom, from downtown to the north shore and west towards Madison. Home prices have grown annually at nearly a double-digit rate over the past few years. Yet the greater metropolitan Milwaukee population from 2000 to 2004 grew a cumulative 1% and real income growth has been anemic. We have articulated previously how illogical it is to have home prices increase significantly faster than the growth in population, income or GDP. A *U.S. News and World Report* study indicated that this year, about 1.2 million families or individuals need housing in the U.S. About 400,000 houses have to be replaced due to obsolescence. Adding 300,000 for second, or vacation, homes sums to a demand figure of approximately 1.9 million. Builders and manufacturers are on track to create over 2.2 million housing units this year. So, supply exceeds demand and prices continue to spike at record rates. It doesn't make sense to us.

The mortgage market exceeds $7 trillion and adjustable rate loans currently represent about 24% of the total. In the past year, over 50% of new mortgages were adjustable rate. Particularly noteworthy is the rapid increase in "interest only" mortgages, with no payments toward principle. It would appear that borrowers are not only taking rate risks, but also stretching for more home than they can afford.

Many people take it on faith that housing prices will never fall. While absolute declines have been rare on a national scale over the past fifty years, there have been numerous instances of regional declines. When viewed on a real (inflation-adjusted) basis, the picture tells a different story. Robert Shiller, a Yale economist, constructed the following chart showing 115 years of real housing prices. One can readily see that real prices can indeed fall — and sometimes for a decade or more. For most of the post-World War II period, housing prices slightly exceeded inflation. In the past five years, prices have spiked dramatically. Of course, one can debate the economic impact of an adjustment in housing prices. We are not predicting Armageddon, but such an adjustment could have a meaningful negative influence on growth. The timing of any correction is impossible to predict. Those clients who were with us in the late 1990s heard us talk a great deal about the technology/telecom bubble. In hindsight we were early, but ultimately we were right. When prices disconnect from economic fundamentals, eventually there is a correction. We do not feel housing will be an exception.



Courtesy of Robert J. Shiller
Irrational Exuberance: Second Edition, 2005

Energy

With the price of oil near $60.00 per barrel, and natural gas prices over $7.00 per thousand cubic feet, there is widespread belief that the world is running out of hydrocarbons. The fundamentals tell a different story. Using data from the Energy Information Administration (EIA) and Platts, an energy publication, Bear Stearns points out that historically there has been a strong correlation between oil inventories in the U.S. and the spot price of oil. This correlation, however, began to break down beginning in January 2004 as fear and speculation took over. The latest report shows U.S. inventory at over 325 million barrels. This is consistent with an oil price between $20-25.00 per barrel. Merrill Lynch's forecast of a 15% rise in global exploration and production spending in 2005 is nearly double the 30-year average of 8%. The production response that follows could lead to a further build in inventory. With respect to natural gas, data from the EIA shows that U.S. storage levels are 15.1% higher than last year and 17.2% higher than the five-year average. The high price of natural gas has led to a significant increase in the rig count. At 1,250 rigs, the Baker Hughes U.S. land rig count is up 17.6% versus the prior year and is over 40% higher than the five-year average. The production response that follows could similarly lead to a further build in inventory.

Thus, rather than the stiff headwind that high energy prices created over the past two years, we are hopeful that relief is on the way. This could help offset some of the negative growth factors discussed above.

Employment

Nonfarm payroll growth, while uneven, remains favorable. The official unemployment rate is 5.1%, which, historically, is a pretty respectable number. We have discussed a number of times in the past that labor force participation (the denominator in the unemployment rate) has grown very slowly over the past several years. Lately there have been some signs that both participation and compensation have accelerated. The ideal scenario is to get participation up without spurring wage inflation. The jury is out on this right now but it is something worth monitoring. In a post-industrial economy, labor is a majority of the expense structure for most firms. It is critical that wages don't escalate faster than output. Frankly, given the pressures coming from India, China and other low cost countries, it's difficult to make the case for lasting wage inflation. Nevertheless, a blip in the wage inflation picture could rattle the market.

Outlook

In a relatively free economy, the normal routine is a cycling process between overly exuberant and overly cautious. The economy is too big and too complex to tweak to the point where no pain is ever felt. For that matter, the economy is probably too big to think that even the Fed's micromanagement can ultimately undo cyclicality. For most of the past decade the Fed seems to have had an aversion to letting events take their natural course. Excesses and shortages send signals to the market that are then exploited one way or the other. Policy makers who try to avoid near term pain often make the eventual adjustment even more severe. This was the case with the stock market in the late 1990s, and perhaps a similar situation is developing in the housing market. In the meantime, the economy is moving along at a reasonably good clip and many foreign economies are looking healthier. The bond market may be correct that a slowdown is just around the corner, but as of today, we don't see it.

From a portfolio standpoint, we remain well-diversified, but significantly underweighted in Energy and Financial Services.

We appreciate your confidence in Fiduciary Management, Inc.

Fiduciary Management Inc.
Large Cap Equity Composite
12/31/2000 - 09/30/2011

Year	Total Return Gross of Fees %	Total Return Net of Fees %	*Benchmark Return %	Number of Portfolios	Dispersion %	Total Composite Assets End of Period ($ millions)	Total Firm Assets End of Period ($ millions)	Percentage of Firm Assets %
2001	20.47	19.70	-11.89	1	0.00	$ 3.6	$ 1,458.2	0.25%
2002	-13.33	-14.11	-22.10	8	0.17	$ 14.0	$ 1,731.0	0.81%
2003	34.29	33.15	28.68	4	0.86	$ 20.8	$ 2,927.0	0.71%
2004	19.32	18.46	10.88	10	0.46	$ 48.9	$ 3,085.8	1.58%
2005	10.22	9.57	4.91	28	0.29	$ 192.2	$ 3,174.4	6.05%
2006	17.91	17.15	15.79	49	0.30	$ 491.0	$ 3,589.4	13.68%
2007	5.05	4.34	5.49	86	0.48	$ 1,000.2	$ 3,960.4	25.26%
2008	-26.38	-26.91	-37.00	130	0.63	$ 1,969.3	$ 4,062.5	48.48%
2009	30.92	30.09	26.46	252	1.22	$ 3,820.3	$ 7,008.9	54.51%
2010	12.52	11.81	15.06	394	0.31	$ 5,923.2	$ 9,816.0	60.34%
Q1 2011	5.01	4.85	5.92	436	0.12	$ 6,717.9	$ 11,338.0	59.25%
Q2 2011	2.07	1.91	0.10	459	0.11	$ 7,701.2	$ 11,819.6	65.16%
Q3 2011	-13.91	-14.04	-13.87	485	0.18	$ 6,989.5	$ 10,357.9	67.48%

*Benchmark: S&P 500 Index®

Effective January 2012, 2004 – 2011 gross and net composite returns were restated due to an error.
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. (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 - 09/30/2011. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Large Cap Equity composite has been examined for the periods 12/31/2000 - 09/30/2011. The verification and performance examination reports are available upon request.

FMI was founded in 1980 and is an independent investment counseling firm registered with the SEC and the State of Wisconsin. The firm manages over $10.3 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 Large Cap Equity Composite was created in December 2000. These accounts primarily invest in medium to large capitalization US equities.

The FMI Large Cap Equity Composite reflects time-weighted and asset-weighted returns for all discretionary accounts. From December 31, 2000 thru September 30, 2002 all accounts included were managed for at least one quarter, from October 1, 2002 to present 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, 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 standard deviation of all accounts in the composite for the entire period.

Currently, the advisory fee structure for the FMI Large Cap Equity Composite portfolios is as follows:

Up to $25,000,000	0.65%
$25,000,001-$50,000,000	0.55%
$50,000,001-$100,000,000	0.45%
$100,000,001 and above	0.40%

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 S&P 500 Index® is widely regarded as the best single gauge of the U.S. equities market. This index includes 500 leading companies in leading industries of the U.S. economy. Although the S&P 500® focuses on the large cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market.
The Large Cap Equity composite uses the S&P 500 Index® as its primary index comparison.