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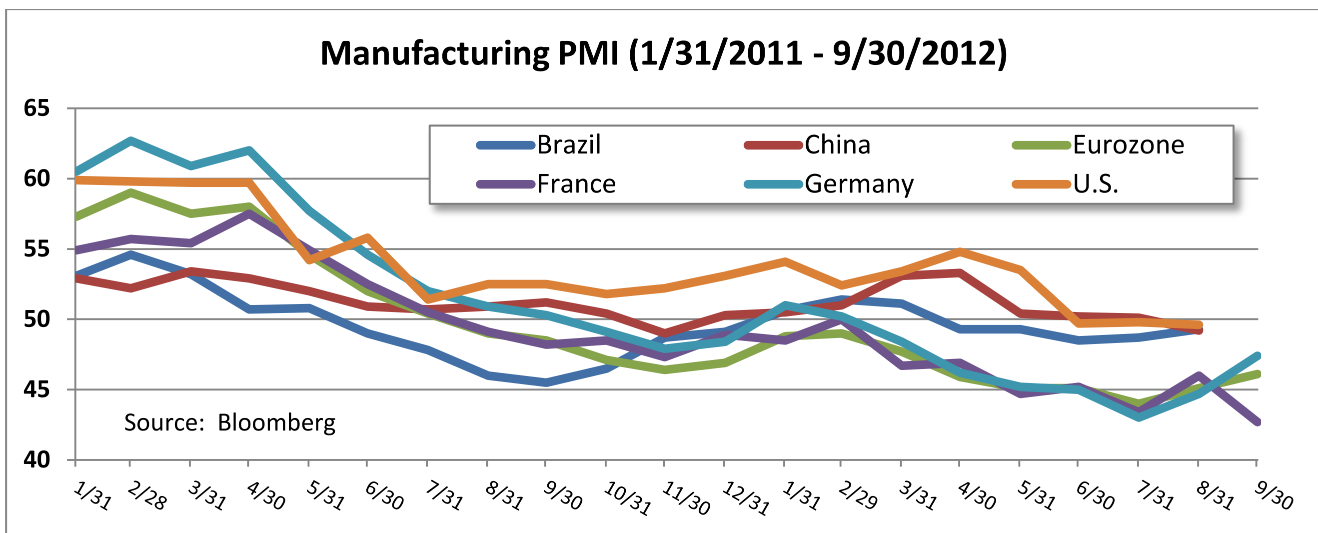
INVESTMENT STRATEGY OUTLOOK – LARGE CAP EQUITY

September 30, 2012

FMI large cap portfolios gained approximately 5.1% in the quarter ending September 30, 2012 compared to the benchmark Standard & Poor's 500 Index return of 6.35%. For the calendar nine months, the large cap portfolios advanced around 14.8%, lagging the 16.44% gain in the S&P 500. From a group standpoint, Finance, Distribution Services, Energy Minerals and Technology Services hurt relative performance, while Consumer Services and Process Industries helped. Staples Corporation continued to perform poorly in the period and the challenges at this company now appear to be more structural and longer term in nature; we decided to sell that position. Our initial foray into Expeditors International proved premature as the slowdown in trade between Asia and the U.S., which we thought was adequately discounted in the price, was not. With economic weakness seeming to accelerate toward the end of the quarter, the takeoff for this stock may be bumpy and elongated. It's an excellent company, however, and has strong management and a gold-plated balance sheet, so we will ride out the cyclical weakness. We've highlighted the stock below. The last stock on the "perp walk" is Willis Holdings. They have struggled to integrate a domestic acquisition and effectively manage a couple of restructurings. While the numbers haven't turned yet, a late September presentation by the company was more encouraging with respect to a U.S. turnaround. The performance of the strategy year-to-date is about what we would expect. Historically we have generally lagged in strong up markets (while more than making up for it in difficult markets). It's not to say we haven't made mistakes, as the scorecard would attest. Our style, however, does seem to be somewhat out-of-favor, with growth stocks significantly outperforming value stocks in recent periods. Finally, the recent rally seems to be more about financial engineering by the Fed than anything fundamental. We're not confident that this "Bernanke trade" will outlast the deteriorating economic and corporate earnings picture.

Most of the major regions of the world seem to be slowing or already experiencing recessionary conditions. The eurozone appears to be in a full-blown recession. China and Brazil have slowed significantly. The United States is sputtering. Economists pay attention to the Purchasing Managers Index (PMI) as an indicator of whether economic conditions are improving or deteriorating (numbers less than 50 indicate deterioration). The United States, China, Germany, Japan, the United Kingdom, Italy, Brazil, Australia, Canada and most of the large countries have PMIs less than 50 (see chart on Page 2).

The recent stabilization of the unemployment rate in the U.S. is undermined by a plunge in the labor force (the denominator in the calculation). The labor participation rate of 63.5% is the lowest in over 30 years. 11.2% of the labor force is out of work, if we include the 7 million no longer seeking employment. The key leading indicator of business capital spending slid 3.4% in July and has been down four of the past five months. Housing has certainly bounced off the bottom, but with true unemployment so high and the economy weakening, we have doubts about a continuing recovery in this sector. Business capital expenditures, incidentally, are 7% of GDP whereas housing is only 2% of GDP. Household net worth is down significantly over the past five years and real incomes have fallen. In short, the economic picture, both here and abroad, is not very good.



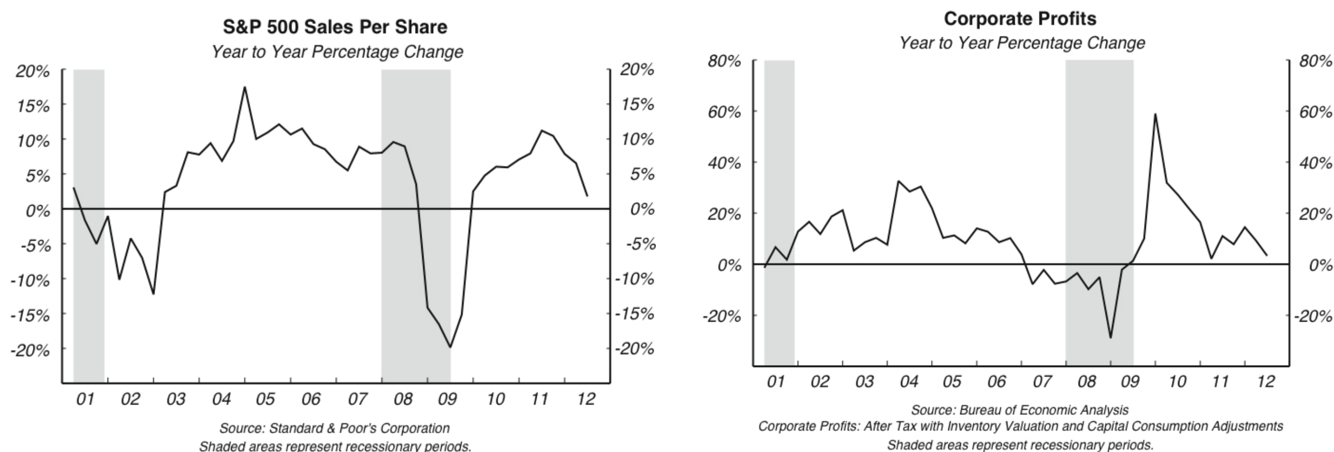
The Fed, European Central Bank (ECB) and other central bankers have taken it upon themselves to fix this problem. That is the way they think. Both the fiscal and monetary authorities look to governments to solve fundamental problems, reflecting a general lack of trust in classic economic policies and free markets. To Mr. Bernanke, the fact that four years of unprecedented stimulus yielded little in the way of results (and has perhaps dangerous long term consequences) is not a reason to stop and reassess. It's an opportunity to say that not enough has been done; it's a call to action. The latest iteration of money printing, QE3, is now underway, with the Fed expanding its balance sheet once again to the tune of an additional $40 billion per month ($85 billion per month in total) indefinitely. Mario Draghi, the head of the ECB, is using the same playbook. He's doing "whatever it takes" to solve the eurozone problem, including an "unlimited" bond buying program. Japan recently followed with a $126 billion "asset purchasing program." Brazil is talking up the same game. Even Switzerland has begun their own version of quantitative easing. In the long run, easy money policies rarely achieve their objectives and often have very serious repercussions. Yet stock markets seem to be cheering it on in the short run.

With the constant calling for governments and central banks to do more, perhaps it would be useful to talk briefly about the potential downside of these policies. Fiscal challenges have been addressed repeatedly in recent letters and will be put aside here, save this one statement: historically, U.S. federal government spending has been about 19-20% of GDP; today it is 24%. From a monetary perspective, we quote the highly respected economist David Malpass: "Whatever the Fed's theory, the reality is that its attempts to prime the pump haven't worked. They distort and weaken the economy and chase capital into such job losers as gold, government bonds, and factories abroad." Today's ground-hugging interest rate policies have decimated the saver and the risk averse. Horizon Kinetics, in their July report, estimates that the U.S. bond market is approximately $36.9 trillion with about 37% ($13.65 trillion) maturing over the next 60 months. The average coupon on maturing bonds is about 4.27% and these are being replaced by bonds with an average coupon of 1.55%. The difference in these two coupons means that if interest rates remain roughly where they are today, $371 billion of income will be lost each and every year for the next five years. That is 2.45% of GDP lost each year (of course, there is an offsetting impact to borrowers). Imagine the fallout if one introduced a tax of this magnitude! Most likely related to quantitative easing, commodity prices have also skyrocketed over the past few years. This has had a very negative impact with respect to food and gasoline prices. It's tantamount to a significant regressive tax. At the same time, the leveraged hedge fund speculators and Wall Street "carry traders" win big from the Bernanke rally. The very people the administration demonizes are the same ones for whom the Fed is throwing a party. It's fascinating, not to mention ironic, to see leaders who denigrated trickle down economic growth theories emanating from lower tax rates now embrace trickle down wealth theories

coming from the Fed. Long term it seems logical to expect what has nearly always happened when governments print money at a far greater rate than the underlying economies are growing: inflation and currency debasement. Interestingly, despite extensive economic weakness, the September eurozone inflation rate is expected to rise to 2.8%, up from 2.6% in August and well above the ECB's target of 2.0%.

Howard Marks, who has managed money for forty years and is one of the great investors of our time, recently made this statement: "The world seems more uncertain today than at any other time in my life." We confess to similar sentiments, but there is always the chance that we are misreading the tea leaves and that the stock market gains anticipate a better economic environment in 2013. Perhaps following the elections Congress will address the so-called fiscal cliff with sensible compromises. Perhaps the leaders will come to acceptable pathways that will reduce deficits and corral the many unfunded liabilities. Perhaps Europe will somehow stem their fiscal and monetary crises and not drag the Federal Reserve into the fray. Every investor has to ask whether these events are likely and whether the 2012 stock market rally already discounts it.

This stock market move, which began in March of 2009, recently hit 43 months, which is the median duration of 15 bull markets since 1929. The 129.6% gain in the current stretch compares to a median of 83.1%. There is nothing magical or predictive from these facts other than to point out that it might take some fundamental improvement in earnings, sales growth or productivity to keep it going. The economic outlook today, both here and abroad, does not look like it will provide much lift in the near term and unfortunately, both sales growth and profit margins appear to be headed the other way, as the following charts depict.



A large number of transportation and industrial stocks are announcing poor earnings outlooks and orders. FedEx, Norfolk Southern, Expeditors, Forward Air, Caterpillar, Navistar, Joy Global, Steel Dynamics, Rockwell and many others have had recent confessions. Stocks that depend on better employment or capital spending have been especially hurt. Business confidence is slipping. It is getting to be an old story but it's impossible to say when it will end. The best we can do in the interim is to let valuation and long term "strength of franchise" be our guide. Higher multiple stocks, lower quality balance sheet stocks, and money losing enterprises have been among the big winners so far in 2012. Valuations remain elevated. We think investors should be wary and stay focused on quality, even if that results in near term underperformance. Somewhat paradoxically, considering the near term economic outlook, the portfolio might begin to tilt more heavily in coming periods toward some of the cyclical companies as their stocks come under increasing pressure. There is always a tug-of-war between valuation and fundamentals and having a long term investment time horizon gives us opportunities to buy superior cyclical franchises when their near term operating environment is weak. We've highlighted one such idea below, Expeditors International.

While today is very cloudy, we do expect sunnier economic times to eventually return, along with better underlying business fundamentals. Why? Business people want to grow. They want to invest. They want to build and they are willing to add labor… when they feel the systems and environment will reward such activity. This will be a far sturdier foundation for equity performance than government stimulus or Federal Reserve financial engineering.

Expeditors International of Washington

(Analyst: Rob Helf)

Description

Seattle-based Expeditors is a $6 billion, international, non-asset-based global logistics provider focused primarily on air and ocean freight forwarding and customs brokerage. The company utilizes its strong relationships with airline and ocean freight carriers, as well as its sophisticated IT systems and professional workforce, to earn strong margins and returns.

Good Business

- Expeditors is a leading provider of international freight forwarding and logistics services.
- The company benefits from the growth of global trade and complex supply chains. Shippers should continue to increase their reliance on leading logistics partners to ease international trade issues.
- The business model is asset-light as the company owns no planes or ships and relies on capacity owners to move the freight. This results in high returns and cash flow.
- Expeditors has built a superior global business platform through organic growth, an integrated IT platform and a committed professional staff.
- The company has ample opportunity to grow as it generates $6 billion in gross revenues, which represents less than 5% of the $150 billion air and ocean freight market.
- The company has an outstanding track record of growth of both sales and profits.
- The business model generates strong returns and cash flow. Historically, Expeditors' return-on-capital has been in the 15-20% range.
- The balance sheet is in terrific shape with a large cash balance ($1.4 billion) and no debt.

Valuation

- Expeditors currently trades at 1.1 times enterprise value-to-sales (EV/S) and 22 times depressed 2012 earnings per share (EPS). On a cash-adjusted basis, the stock trades at 18 times EPS.
- Historically, the stock has traded at 1.6 times EV/S and 33 times EPS. The shares are at discount to one standard deviation below their historical mean.

Management

- Expeditors' management team has delivered steady growth and profitability for years. Importantly, management takes a long-term view of the company, eschews a short-term, Wall Street mentality and uses compensation as a powerful tool to incentivize its professional staff. The company has maintained a consistent compensation philosophy which includes a modest base salary and the opportunity to share in a fixed percentage of profits generated. This has resulted in superior value creation for shareholders and has motivated employees.
- Mr. Peter Rose is Chairman and CEO of Expeditors. He has served as a director and officer of the company since 1981.
- Mr. James Wang is President-Asia Pacific and has served as a director since 1988. R. Jordan Gates is President and COO. He is also a director and joined the company in 1991.

Investment Thesis

Expeditors has built an enviable international forwarding platform with both strong customer and asset-owner relationships. It has grown at above-average rates over the past decade while generating high returns-on-capital. The shares, which historically have carried a large growth premium, are down substantially. Recent concerns over international trade volumes, particularly coming east from Asia, and paradoxically (given economic weakness) tight commercial airlines lift capacity, have provided an entry point for this strong franchise. Over the long run, we expect Asian growth to resume, and for Expeditors to regain some of its former premium.

Sysco Corporation

(Analyst: Karl Poehls)

Description

Sysco is the largest provider of foodservice products in the U.S. and Canada, distributing more than 300,000 products to 400,000 restaurants, schools, hotels, health-care institutions, and other foodservice customers. Restaurants account for two-thirds of Sysco's annual sales, with independents contributing 60% of restaurant sales and chains making up the rest. The company's SYGMA network focuses on serving large chain restaurants in the quick-service or quick-family markets (13% of revenues).

Good Business:

- Sysco is a dominant franchise and industry leader; it is the largest foodservice distributor in the U.S. with 18% market share, and benefits from significant economies of scale. Evidence can be found in the company's operating margin, which is roughly 3x its closest competitor.
- The company provides products that are necessities for daily life, and is an easy business to understand.
- Sysco has a long history of generating extremely consistent revenues and earnings.
- Sysco generated a strong return on invested capital (ROIC) of 14.8% in fiscal 2012 versus a 5-year and 10-year average ROIC of 17.6% and 20.0%, respectively.
- Generation of excess free cash flow in conjunction with modest capital requirements has allowed the company to return 67% of net income to shareholders over the past 5 years, through a combination of dividends and share repurchases.
- The balance sheet is conservatively financed and Sysco maintains an A+ senior bond rating from Standard & Poor's.

Valuation

- Sysco's stock is trading 24% below its all-time high and has been a laggard for a number of years.
- The company's current EV/S multiple is 0.46 times which is one standard deviation below its 10-year average multiple of 0.63 times.
- Sysco's current EV/EBITDA (earnings before interest, taxes, depreciation and amortization) multiple is 8.4 times, nearly one standard deviation below its 10-year average multiple of 10.4 times.
- The company's fiscal year 2013 price-to-earnings (P/E) multiple is 15.6 times very depressed earnings, which compare to the trailing 5-year and 10-year average P/E multiples of 15.2 times and 19.9 times, respectively. Further, the company's substantial business transformation investment is expected to depress fiscal 2013 earnings by $0.30 per share.
- Precedent mergers and acquisitions transactions announced for 12 comparable companies between 2000 and 2007 were executed at a median EV/EBITDA multiple of 11.0 times.
- Sysco's common shares have an attractive 3.5% dividend yield.

- A conservative discounted cash flow (DCF) valuation yields a per share value 30% higher than the current stock price.

Management

- Sysco's top 10 executive managers have been with the company for an average of 20 years.
- Executive management is compensated based on three key operating metrics: earnings per share growth, return on equity, and operating company performance.

Investment Thesis

Over the past 5 years, the U.S. casual dining industry has experienced an unprecedented downturn with 20 consecutive quarters of negative traffic growth before seeing slight improvement in 2011. This headwind has brought the historically strong growth in Sysco's revenues and earnings to a near standstill. In addition, the company is investing north of $1 billion to improve its internal operations, including the implementation of a company-wide enterprise resource planning (ERP) system, which has led to elevated operating expenses. These factors have limited investor excitement about Sysco's near-term outlook. However, the company continues to strengthen its competitive position and its shares are available at an attractive valuation.

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

Fiduciary Management Inc.
Large Cap Equity Composite
12/31/2001 - 06/30/2012

Year	Total Return Gross of Fees %	Total Return Net of Fees %	*Benchmark Return %	Number of Portfolios	Dispersion %	Three Year Ex-Post Standard Deviation Composite	Three Year Ex-Post Standard Deviation *Benchmark	Total Composite Assets End of Period ($ millions)	Total Firm Assets End of Period ($ millions)	Percentage of Firm Assets %
2002	-13.33	-14.11	-22.10	8	0.17	n/a	n/a	$ 14.0	$ 1,731.0	0.81%
2003	34.29	33.15	28.68	4	0.86	n/a	n/a	$ 20.8	$ 2,927.0	0.71%
2004	19.32	18.46	10.88	10	0.46	n/a	n/a	$ 48.9	$ 3,085.8	1.58%
2005	10.22	9.57	4.91	28	0.29	n/a	n/a	$ 192.2	$ 3,174.4	6.05%
2006	17.91	17.15	15.79	49	0.30	n/a	n/a	$ 491.0	$ 3,589.4	13.68%
2007	5.05	4.34	5.49	86	0.48	n/a	n/a	$ 1,000.2	$ 3,960.4	25.26%
2008	-26.38	-26.91	-37.00	130	0.63	n/a	n/a	$ 1,969.3	$ 4,062.5	48.48%
2009	30.92	30.09	26.46	252	1.22	n/a	n/a	$ 3,820.3	$ 7,008.9	54.51%
2010	12.52	11.81	15.06	394	0.31	n/a	n/a	$ 5,923.2	$ 9,816.0	60.34%
2011	2.35	1.74	2.11	509	0.37	18.34%	18.70%	$ 8,434.8	$ 12,273.6	68.72%
Q1 2012	11.31	11.16	12.59	510	0.25	15.57%	16.00%	$ 9,799.5	$ 14,145.3	69.28%
Q2 2012	-1.83	-1.99	-2.75	518	0.14	14.84%	15.88%	$ 10,414.3	$ 14,510.6	71.77%

*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 - 06/30/2012. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Large Cap Equity composite has been examined for the periods 12/31/2000 - 06/30/2012. The verification and performance examination reports are available upon request.

FMI was founded in 1980 and is an independent investment counseling firm registered with the SEC and the State of Wisconsin. The firm manages over $14.5 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 with a market value greater than $500,000 as of month end beginning January 1, 2012. 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 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®.

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.