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INVESTMENT STRATEGY OUTLOOK – LARGE CAP EQUITY

March 31, 2015

The FMI Large Cap portfolios returned approximately 2.0% in the March quarter compared to the benchmark Standard & Poor's 500 Index gain of 0.95%. Sectors that helped this quarter included Distribution Services, Health Services and Consumer Non-Durables, while Health Technology, Technology Services and Process Industries detracted from performance compared to the S&P 500. Stocks that performed well in the period included AmerisourceBergen, UnitedHealth Group and TE Connectivity. These gains were balanced by negative results from American Express, Potash Corp and PACCAR; we continue to like the long-term outlook for all three of these investments. Cash remained a drag on performance. Other than tactical boosting and trimming, the only across-the-board portfolio move in the quarter was the sale of Cintas, which reached a very full valuation.

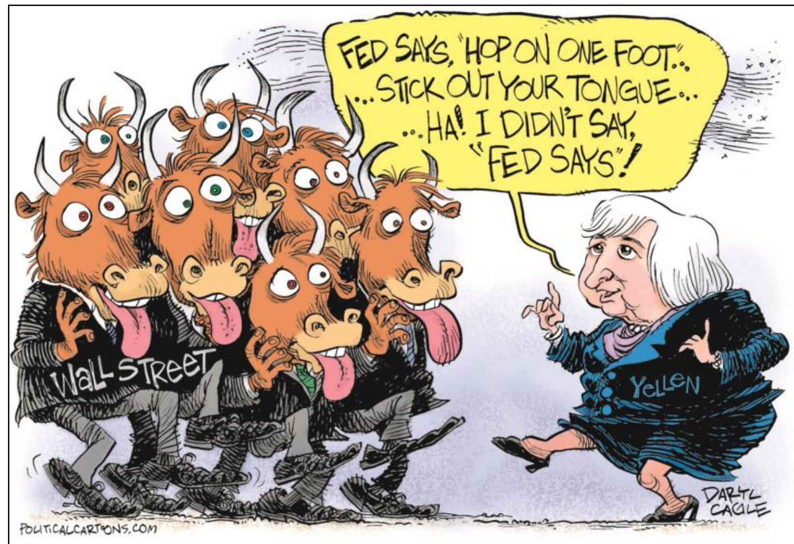
Aside from a few bumps at the end of the quarter, the six-year bull market remained intact through March. It is difficult to reconcile the trajectory or the level of stock, bond, real estate and most other financial assets over most of the past several years given the fundamentals. It might be tempting to just sit back and enjoy the ride, but having a strong conviction that there is an artificiality to the great success these markets have enjoyed keeps us from joining in the fun. Despite a torrent of fiscal stimulus resulting in a staggering debt load of $18 trillion and enormously accommodative monetary policies, the U.S. economy continues to perform in subpar fashion. U.S. real gross domestic product (GDP) growth over the past five years has averaged 2.3%, less than half the normal rate. Many other developed countries are in the same predicament. International Monetary Fund (IMF) estimates of global GDP growth have recently been cut again, from 3.8% to 3.5%. U.S. industrial production, durable goods spending, and business formations have all recently weakened. Housing starts and existing sales have been up and down, but far below what most predicted for five years after a recession. First quarter retail sales look like they will be down at least 2%. The unemployment rate has improved, but that is modest solace considering the near record-low labor participation rate of 62.8%. While this figure might have some downward influence from baby boomers retiring early with no desire to reenter the workforce, millions have become discouraged and have simply stopped looking for work, and are thus no longer counted as unemployed. Labor's share of profits is low relative to history and real incomes have been stagnant for over a decade, unless you are in the small slice at the top. Corporate sales and earnings growth rates have declined sharply in recent months (likely to be down in the first quarter), partly due to weak oil prices and the strong dollar, but also affected by a lack of organic fixed business investment, research and development, and people. Corporate executives have become slaves to Wall Street, buying back stock at record-high levels and worshipping at the mergers and acquisitions altar. Government leaders and central bank bureaucrats continue to push the same policies regardless of the outcomes and despite the alarming increase in long-term liabilities and distortions to healthy and sustainable economic activity.

It may be hard to imagine, but since the financial crisis, which was partially due to an excessive credit expansion, the world has added even more debt than it did in the run-up to the peak (2000-2007). Quoting from a McKinsey report:

> Seven years after the bursting of a global credit bubble resulted in the worst financial crisis since the Great Depression, debt continues to grow. In fact, rather than reducing indebtedness, or deleveraging, all major economies today have higher levels of borrowing relative to GDP than they did in 2007. Global debt in these years has grown by $57 trillion, raising the ratio of debt to GDP by 17 percentage points. That poses new risks to financial stability and may undermine global economic growth.[1]

[1] Richard Dobbs, Susan Lund, Jonathan Woetzel, and Mina Mutafchieva. "Debt and (not much) deleveraging." McKinsey Global Institute Report, February 2015.

Most investors continue to put their money and faith with Fed Chairwoman Yellen's interest rate oracles, but it is clear, at least to us, that she and most of the Fed governors are perplexed by the spotty labor markets and the underlying health of the economy. It comes as no surprise that pumping up asset values in an attempt to induce a wealth effect-driven economic expansion has, and will continue to fail on many levels. While it is logical to expect small wealth effect spending by a few middle and upper-middle income folks who happen to own modest financial asset portfolios that rise substantially, the fact is, the vast majority of financial assets are owned by the top 10% of the population. If we were to double Warren Buffett's wealth, how much more would he consume? Probably very little, and thus the impact on the economy would be negligible. An unnaturally low interest rate policy favors speculators, deal-makers and financial engineers. Only a vibrant economy with organic growth opportunities will induce true risk-takers to invest in people and capital.



The six-year bull market, combined with tepid fundamentals, has made stocks remarkably expensive from a historical perspective. The median or "typical" stock is higher than we have ever seen, and even more expensive than during the peak of the technology and telecom craze in 1999. Today there are over seventy start-ups with valuations over a billion dollars compared to less than half of that, inflation adjusted, in the 1999-2000 period. Pharmaceutical companies are brawling with each other to pay 5-10 times multi-year-out hoped-for *revenue* for phase III or recently approved compounds. Unnaturally-low interest rates foster this behavior. Bond valuations have reached epic levels nearly everywhere with ground-hugging rates here in the U.S., and even negative rates in some countries. A number of real estate sectors, particularly those catering to the wealthy, appear highly inflated, reminiscent of ten years ago.[2] Real estate investment trusts (REITs) are as pricey as we can ever recall. Strangely, the sheer length of this asset inflation cycle has people feeling emboldened to take more risk rather than trimming their sails. In his book, *Inefficient Markets, An Introduction to Behavioral Finance,* Andrei Shleifer said, "Investor sentiment reflects the common judgment errors made by a substantial number of investors, rather than uncorrelated random mistakes."

A tremendous surge of funds moving toward passive index strategies has created an environment where the flows themselves are driving performance. According to Morningstar, in 2014 U.S. active equity funds experienced $98.4 billion of outflows, while passive funds received $166.6 billion of inflows. This self-reinforcing cycle is not uncommon in the latter stages of bull markets. Investors and investment committees continue to capitulate on active management, throwing in the proverbial towel and going passive when they should be de-risking to cash or moving to more conservative active management. Index funds have taken on somewhat of a life of their own, divorced from underlying fundamentals. Last year, just 25 companies, or 5% of the S&P 500 constituents, accounted for approximately 50% of the total return. Eventually, negative developments affect the top-heavy indices, and as long as there is still an active investment community reacting to this, it sets the process in reverse, with the weightiest components falling the hardest as monies flow out, disproportionately hurting index products, which inures to the benefit of the more conservative active managers. The caveat is that these cycles can sometimes be excruciatingly long, as evidenced by the current one. An added feature to the complexion of the market is that unlike in 1999, when performance was also quite concentrated, today's market, even outside the weightiest names, is still expensive.

Another way to view stock market cycles is to look at the relative performance of growth versus value strategies. Using the Leuthold data, the nearby chart shows the last forty years of these cycles. Given all that we have said in recent letters

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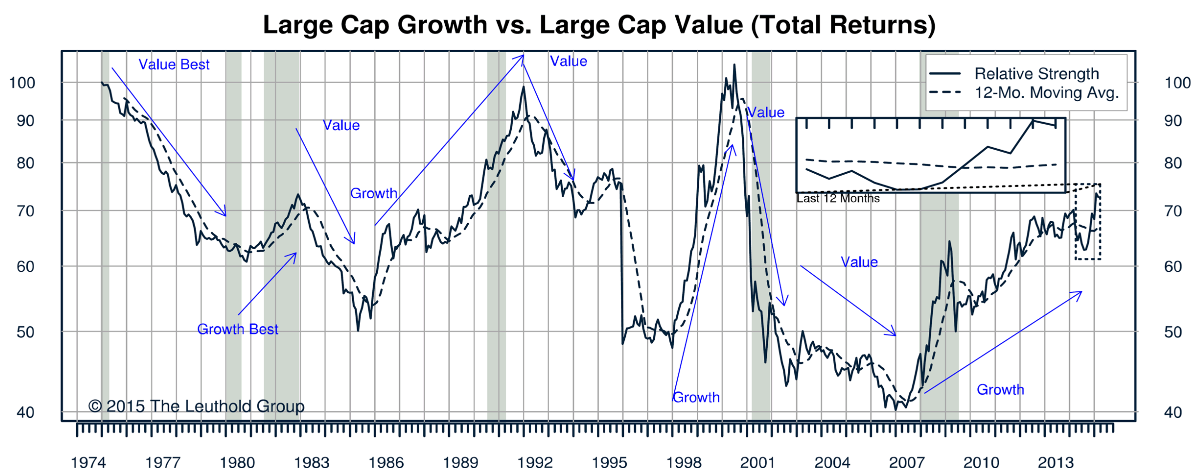
[2] Erin Carlyle. "America's Most Expensive Home Sales of 2014." *Forbes*, December 24, 2014.

about what is happening in the market and the types of companies that are garnering the limelight, it won't come as a surprise to see that the past seven years have been driven by growth stocks. It has certainly been a headwind for us. Over the entire period, however, value has outperformed growth by a quite substantial 25%. Data stretching back ninety years also shows value outperforming growth. Sharp-eyed observers of this chart will see, however, that there was a brief moment in 1999 where growth had beaten value over a 25-year period. We certainly hope the current seven-year run stops in its tracks, but of course there is no way to predict or assure that.



Finally, for those who think prices and markets rarely change quickly, look at oil prices over the second half of 2014. Oil dropped from roughly $100 per barrel in June to approximately $50 in December. A year ago, the overwhelming consensus was that oil was hard to find and prices would grind higher, with many experts calling for $200 oil within a few years. Today the sentiment has completely flipped, with many of the former bulls saying it may be many years before we see $100 again.

As always, the research team continues working hard to try to find potentially good ideas that we feel have less downside risk than the typical stock. Below we highlight two of these ideas.

TE Connectivity (TEL)

(Analyst: Andy Ramer)

Description

TE Connectivity is the global leader in connectors and sensors, with the broadest portfolio of products in this $165 billion market. Transportation is the Company's largest end market at over 50% of pro forma sales.

Good Business

- Pro forma the sale of the Broadband Network Solutions business (BNS), approximately 90% of the portfolio provides leading connectivity and sensor solutions. Their focus on providing increasingly complex, application-specific solutions raises the barriers to entry – 80% of sales will be generated from harsh environment applications that require highly-engineered solutions.
- Connectors and sensors are a ubiquitous feature in every electronic device. The proliferation of electronics and increasing content penetration is driving demand for TE's products, which represent a low-single-digit percentage of the bill of materials.
- Return on invested capital (ROIC) improved to 12.5% in fiscal year 2014, with 3- and 5-year returns on incremental invested capital in the range of 25% to 30%.
- This business is easy to understand.
- The balance sheet is strong and the company generates a prodigious amount of free cash flow.

Valuation

- TE trades for 16.8 times calendar year 2015 earnings per share forecasts, a significant discount to the median and weighted average multiples for the S&P 500 of 18.5 and 21.6, respectively, as well as its closest peer Amphenol, which trades for 23.8 times.
- Koch Industries announced the acquisition of competitor Molex in September of 2013 for 22 times consensus calendar year 2014 earnings per share estimates. Ascribing a similar multiple to TE would represent upside of around 30%.
- Free cash flow approximates net income and thus yields 6.0% on calendar year 2015 forecasts.

Management

- Tom Lynch has served as CEO since January of 2006 and was elected Chairman in January of 2013. Terrence Curtin serves as President and is responsible for all of the Connectivity and Sensors businesses and merger and acquisition activities. Bob Hau joined TE in August of 2012 as CFO.
- Since being spun off from Tyco International in June of 2007, management has worked to reposition TE as a faster-growing, more profitable enterprise. Most recently, the company announced the sale of its volatile and underperforming BNS division to CommScope in January of 2015 for $3.0 billion, or 10 times EBITDA (earnings before interest, taxes, depreciation and amortization); the majority of the sale proceeds will be used for share repurchases.
- TE expects to continue to return roughly two-thirds of free cash flow to shareholders over time, with the remaining one-third dedicated to making small- and mid-sized acquisitions.

Investment Thesis

Increasing electronic content and design wins are expected to result in long-term organic sales growth of 5-7% per year, which in turn should drive approximately 50 basis points of annual operating margin expansion. When combined with stock buybacks, earnings per share is expected to grow at a double-digit compound annual rate. TE is an above-average company that is trading at a well-below-average multiple.

Comcast Corp. (CMCSA)

(Analyst: Dan Sievers)

Description

Comcast Corp. (CMCSA) is the largest cable multiple-system operator (MSO) in the United States, with this business contributing 63% of sales and 76% of EBITDA. In 2014, its networks passed an estimated 54.7 million homes and businesses (+2% year-over-year) with residential subscriber penetration of video at 40.9% (22.2 million subscribers) and internet at 40.2% (22 million subscribers). Comcast's coaxial networks were rebuilt in the 2000s and now boast high-capacity fiber optic backbones (over 145,000 fiber miles). Business services revenue grew 22% in 2014 to 9% of MSO revenue. Comcast can deliver 105 megabits per second internet speed to all customers on the DOCSIS 3.0 standard, with DOCSIS 3.1 promising much higher speeds, even without replacing node-to-home coaxial cables. The remaining 36% of sales and 24% of EBITDA comes from NBC Universal (NBCU), a large media conglomerate acquired from GE (51% in 2009 and 49% in 2012), which owns the NBC and Telemundo broadcast networks, 27 local stations, popular cable networks, major studio assets, and theme parks.

Good Business

- Industry-wide, cable video subscriptions have fallen every year since 2001, and we expect further attrition. Bundled pricing practices distort reported cable video and internet revenue contribution (overstating video). Rising programming costs have rendered video a low-margin business, while residential and business internet services are high-margin businesses (and are growing much faster).
- Cable MSOs are the low-cost providers of fast broadband internet service, due to the robust nature of existing hybrid fiber/coaxial (HFC) network architectures. Cable internet continues to take residential and business market share from telco DSL, which cannot compete on speed. This is a recurring revenue, high-margin business.
- The FCC's recent Open Internet (or Net Neutrality) rule, released March 12, 2015, reclassifies internet access service providers (ISPs) as Title II common carriers under the 1934 Communications Act, but applies forbearance to most of

the critical elements surrounding pricing. Reversing forbearance would require solicitation of public comment (over several months) and detailed responses to public criticism and concerns.

> From page 12: "Our forbearance approach results in over 700 codified rules being inapplicable, a "light-touch" approach for the use of Title II. This includes no unbundling of last-mile facilities, no tariffing, no rate regulation…"
>
> From page 214: "…we do not and cannot envision adopting new *ex ante* regulation of broadband Internet access service in the future…"

- NBCU controls an attractive stable of networks (USA, SyFy, E!, Bravo, etc.) and content, including news (NBC, CNBC, MSNBC) and sports (NBC, NBC Sports, Golf), with NBC broadcast contributing significant margin-accretive growth via retransmission consent fees. Overlooked assets include NBCU's national and local broadcast spectrum and 30 Rockefeller Center.

Valuation

- If NBCU were valued even at a discount to its peer group average at 10x 2014 EBITDA (30% of enterprise value), then Comcast Cable is valued at an attractive 7.24x 2014 EBITDA (70% of enterprise value).
- Comcast is under-levered with net debt equal to 1.86 times 2014 EBITDA.
- Comcast trades for 17.3 times estimated 2015 earnings compared to the 10-year P/E average of 23.

Management

- Brian Roberts (son of founder Ralph Roberts), is President (1990), CEO (2002), and Chairman (2004), and controls one-third voting interest in Comcast through non-traded B share ownership.
- Comcast has a deep bench of talented executives, several of whom own significant Comcast shares.

Investment Thesis

Despite the FCC's recent reclassification, we feel that Comcast is very well positioned for the future. Pundits continue to misunderstand the limited cash flow contribution of cable video, where subscriber reductions produce limited impact. HFC networks capable of providing ever faster internet services should be regarded as appreciating assets. Comcast's valuation multiples are attractive given its double-digit earnings per share (EPS) outlook, its low debt leverage, the possibility of flat or declining capital intensity, and its ability to utilize its fixed network to offer new and related services (business services, home security, wireless mobile virtual network operator mobile phone services, etc.).

Thank you for your support of Fiduciary Management, Inc.

Fiduciary Management Inc.
Large Cap Equity Composite
12/31/2004 - 12/31/2014

Year	Total Return Gross of Fees %	Total Return Net of Fees %	*Benchmark Return %	Number of Portfolios	Dispersion %	Three Year Ex-Post Standard Deviation Composite	*Benchmark	Total Composite Assets End of Period ($ millions)	Total Firm Assets End of Period ($ millions)	Percentage of Firm Assets %
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%
2012	16.02	15.32	16.00	575	0.32	13.94%	15.09%	$ 11,270.3	$ 15,253.5	73.89%
2013	31.87	31.10	32.39	685	0.31	11.38%	11.94%	$ 15,785.5	$ 19,705.3	80.11%
2014	13.52	12.81	13.69	725	0.25	8.54%	8.98%	$ 16,084.1	$ 21,001.1	76.59%

*Benchmark: S&P 500 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. (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 - 12/31/2014. 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 - 12/31/2014. 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 $21.0 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.