



100 East Wisconsin Avenue, Suite 2200
 Milwaukee, Wisconsin 53202
 414-226-4545
 www.fiduciarymgt.com

INVESTMENT STRATEGY OUTLOOK – LARGE CAP EQUITY

March 31, 2017

The FMI Large Cap portfolios advanced approximately 5.7% in the March quarter compared to 6.07% for the Standard & Poor’s 500 Index (S&P 500). Consumer Services, Consumer Non-Durables and Producer Manufacturing sectors outperformed in the quarter, while Electronic Technology, Retail Trade and Process Industries lagged. Twenty-First Century Fox (“Fox”), Unilever and Rockwell Automation were the leaders in each of the outperforming groups. Media stocks in general had a good quarter and Fox also reported solid results; Unilever benefitted from a takeover bid by Kraft-Heinz (rebuffed); and a number of cyclical stocks, including Rockwell, moved higher on the expectations of better economic growth. Rockwell was sold due to a valuation that was nearly two standard deviations higher than its ten year historical mean, based on enterprise value-to-sales data. The below-average results in Electronic Technology were due to our underweighted sector position. Dollar General hurt the Retail Trade sector as concerns about overall pricing pressure permeated the space. Potash Corp. also declined in the quarter, as the market continued to focus on near-term capacity additions.

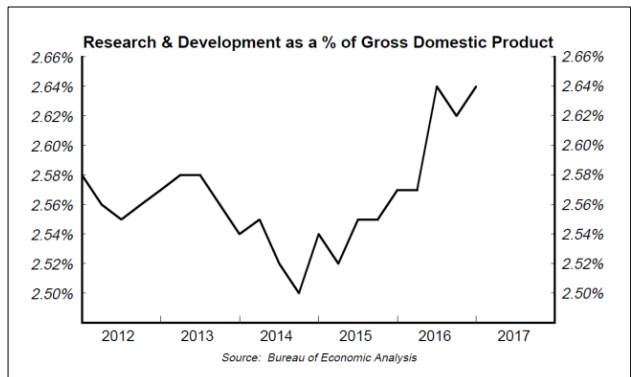
We have to admit that it has been a struggle in recent years to keep these missives fresh. There are only so many ways to say the same thing! An enduring belief in the continuation of an environment that yields low interest rates, low inflation and no accidents seems to be the law of the land, even though a rational survey of history would lead to the opposite conclusion. The economy has been trapped in low growth, earnings gains have been meager, and valuations have continued to climb as stocks have outpaced fundamentals. Promises of more rapid economic growth and a normalization of interest rates have been “right around the corner” for five or six years. Of course there is no guarantee that stocks will continue to appreciate even if the economy snaps-to, but unless one believes in a perpetually rising price-to-earnings multiple machine, it’s the best chance. Recently there has been increased optimism that the economy is indeed gathering steam and that we are on the verge of an economic breakout. Let’s articulate some of these green shoots.

The Purchasing Managers Indices in the U.S., Asia and Europe have been steady or have improved over the past several months, as depicted in the nearby table to the right (readings over 50 indicate expansion).

	Markit US Composite PMI (SA)	Markit Eurozone Composite PMI (SA)	Nikkei Japan Composite PMI Output (SA)	Caixin China Composite PMI Output (SA)
Mar-17	53.2	56.7		
Feb-17	54.1	56.0	52.2	52.6
Jan-17	55.8	54.4	52.3	52.2
Dec-16	54.1	54.4	52.8	53.5
Nov-16	54.9	53.9	52.0	52.9
Oct-16	54.9	53.3	51.3	52.9
Sep-16	52.3	52.6	48.9	51.4

Source: Bloomberg

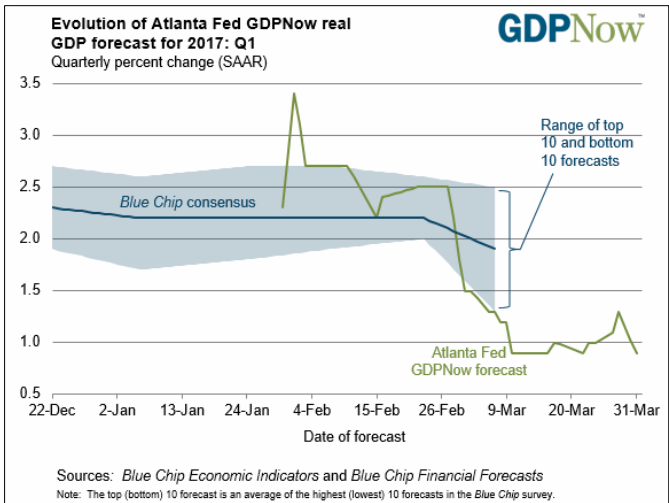
The Richmond Federal Reserve reported an exceptionally strong March Purchasing Managers’ Index (PMI) figure of 59.4. Export activity in a number of important trade centers has started to improve, according to *The Economist*. Research and development (R&D) spending has also begun to advance, based on Factset’s analysis of every company in the S&P 500 and broader measures provided by the Bureau of Economic Analysis (as can be seen in in the accompanying chart).



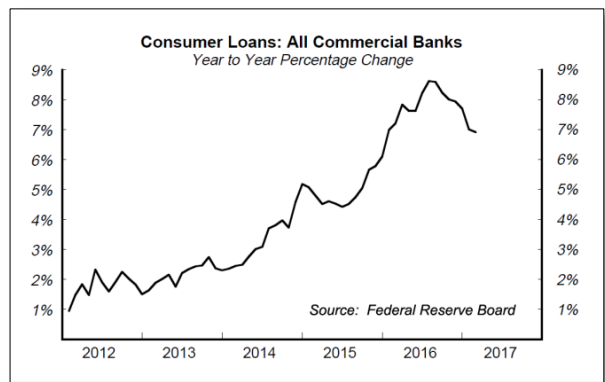
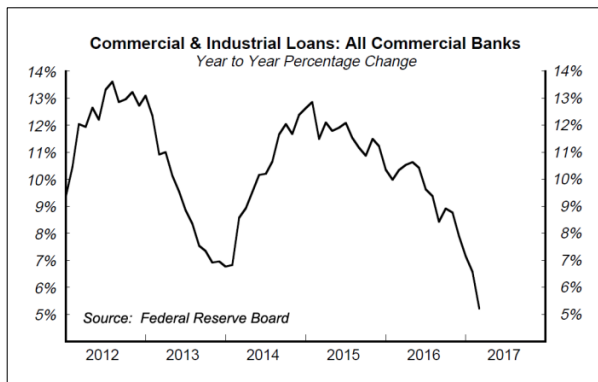
U.S. fixed business investment has recently edged higher. After being negative for the first three quarters last year, J.P. Morgan recently reported that worldwide equipment spending (excluding China) grew at a 4.1% annualized rate in the fourth quarter. Improved R&D and capital investment are two critical keys to attaining long-term economic growth. Additionally, U.S. nonfarm payrolls grew a relatively healthy 235,000 in February, and there was further evidence that

European employment has gained ground. Both Germany and France showed an employment PMI above 50 and overall Eurozone unemployment continued to fall from the peak of 12.1% four years ago to a recent 9.5%. Producer prices have edged higher in the U.S. and a number of other developed economies. U.S. consumer sentiment indices are all flashing green.

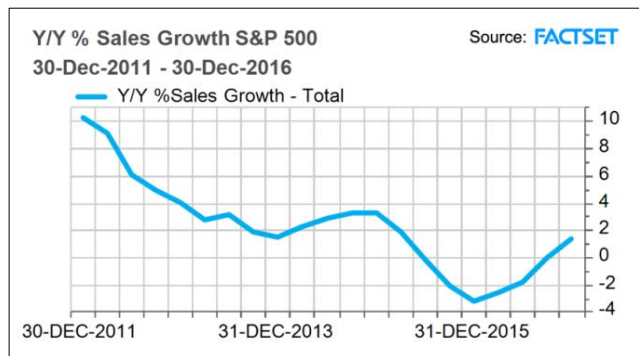
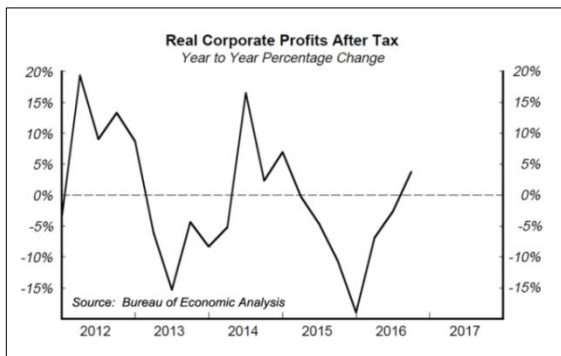
Main Street, if not Wall Street, will be thrilled if these budding positives manifest themselves into true and enduring economic growth. Counter to these positives, however, are some nagging figures. The GDPNow survey from the Atlanta Federal Reserve has been trending steadily down since late January, when estimates for first quarter Gross Domestic Product were over 3% compared to the latest data point of 1% (see chart to the right). The chart also shows the Blue Chip consensus forecast fading.



Additionally, lending activity has really begun to slow, which rarely happens when the economy is on the verge of stronger growth. David Rosenberg of Gluskin Sheff recently discussed this slowdown and we've included pictorials below of a couple of the bigger categories (Commercial and Industrial loans and Consumer Loans). Auto loan growth has also begun to recede.



We read and listen to dozens of corporate calls each quarter, and while there is more optimism in the air, actual earnings growth overall remains somewhat stagnant, and is, at best, just inching ahead at a low single-digit rate, as the first chart below indicates. Many of the cyclical companies are still seeing earnings declines. After years of cost cutting, our sense is that companies are nearing the limit in terms of margin expansion. For the next several years it will be difficult for businesses to grow earnings without experiencing better revenue growth, and we haven't seen strong evidence of this yet -- though it is improving, as the second chart below depicts.



In last quarter's letter we said the new administration had a number of things it wanted to accomplish in fairly short order. To quote ourselves, "Real reform of all of these elements will largely take place on Congress' time table, not the president's -- and probably not Wall Street's either." The aborted attempt to repeal and replace the Affordable Care Act shows just how true this statement was, and how challenging it will be for the erstwhile opposition party to govern. As of the end of March, the bull market was still intact, so there hasn't yet been a stock market price to pay for the lack of legislative progress. Tax reform appears to be next on the agenda, and we'll reserve judgment until we see something more legislatively plausible than the first pass, which included a border tax (BAT) that uses suspect economic theory and is very unpopular with key constituents. Retailers, for example, will be severely damaged by the BAT and there are 15.9 million retail employees in the U.S. compared to 12.3 million manufacturing employees. This isn't to suggest that retail is more important than manufacturing, but it does point out the political difficulty in favoring one industry over another. The Republicans seem too timid to offer a truly simplified tax policy... one that offers a relatively low flat rate in exchange for the elimination of deductions. The timing and character of the horse trading that plays out with tax reform will determine whether immigration, healthcare, entitlement reform or infrastructure investment initiatives reach the president's desk within the next year or two. Given the recent healthcare legislative results, tax reform is likely to be the defining litmus test for the 115th Congress and the Trump administration.

One thing has remained constant over the past eight years despite historically anemic economic fundamentals: an unshakeable stock market. We won't rehash the plethora of data that shows median valuations are greater than they have ever been, and weighted average measures are nearing the all-time highs of early 2000. Bullish sentiment by investment advisors is also very high, and as mentioned, consumer confidence is elevated. The Conference Board's Consumer Confidence Index reached 125.6 in March, the highest it has been since December of 2000. Speculative sentiment and overconfidence combined with expensive valuations is not a recipe for good stock market returns. At some point confidence will be pricked and money will flow out rather than in for a period. From time eternal that is how markets have behaved. The market will give us the opportunity to deploy some cash and upgrade a handful of existing holdings to even better businesses. We have been working hard to build our idea inventory with high-quality businesses that are just too rich to own today; in the meantime, we are finding a few solid franchises with relatively attractive valuations. Two are highlighted below.

Cerner Corporation (CERN)

(Analyst: Matt Sullivan)

Description

Cerner is a leading supplier of healthcare information technology. The company offers a wide range of solutions and services that support the clinical, financial, and operational needs of healthcare organizations of all sizes. They have systems in more than 25,000 facilities worldwide, including hospitals, physician practices, laboratories, ambulatory centers, behavioral health centers, cardiac facilities, radiology clinics, surgery centers, extended care facilities, retail pharmacies, and employer sites. Cerner was founded by Neal Patterson, Cliff Illig, and Paul Gorup in 1979 and is headquartered in North Kansas City, Missouri.

Good Business

- The business has a significant amount of recurring revenue. We estimate that somewhere around 70% of sales and over 80% of gross profits are recurring in nature.
- Cerner's software and services are mission critical for customers and have high switching costs.
- Cerner is one of the dominant players in the healthcare IT industry. They are one of only a few industry players to have fully integrated clinical and financial software solutions across the continuum of care.
- A large portion of Cerner's future growth will come from selling existing customers additional software and services. We believe this is an attractive growth opportunity, as Cerner is already highly-entrenched within these customers' operations, and customers are increasingly looking for integrated IT solutions.
- The business generates solid free cash flow and high returns on invested capital (ROIC). Excluding cash on the balance sheet, the company has averaged a 19% ROIC over the past five years.
- The balance sheet is in terrific shape with very little net debt.

Valuation

- The stock performance is down around 12% from its 52-week high and has underperformed the S&P 500 by 38% and 29% over the past two and three years, respectively, on a total return basis.
- Cerner trades at 4.1 times sales, which is more than one standard deviation below the five-year historical average of 5.5 times sales.
- The company trades at 13.5 times trailing earnings before interest, taxes, depreciation and amortization (EBITDA), and 12.0 times the 2017 estimated EBITDA, both of which are more than one standard deviation below the five-year historical average of 17.8 times EBITDA.
- The valuation is very reasonable on a relative basis when compared to other healthcare stocks and the broader S&P 500, especially when considering Cerner's entrenched market position, high returns on capital, and solid long-term growth prospects.

Management

- Cerner has a highly experienced management team; most high-level executives have been at the company for over a decade.
- Neal Patterson is a co-founder of the company and has been a director since 1980. Patterson has been Chairman of the Board of Directors and Chief Executive Officer for more than five years.
- Marc Naughton joined Cerner in 1992 and has served as Chief Financial Officer since 1996, and Executive Vice President since 2010.
- Management prefers to grow organically rather than through acquisitions. Most excess free cash is used to repurchase the company's own stock. We view this as an attractive capital allocation philosophy.

Investment Thesis

Cerner is a terrific franchise with strong recurring revenue, high switching costs, a dominant market position, high returns on capital, and a pristine balance sheet. Following the election of Donald Trump, uncertainty regarding the replacement of the Affordable Care Act put pressure on a number of healthcare stocks, including many in the healthcare information technology industry. While we don't know what may happen legislatively, we are confident that information technology will have an increasingly important role in delivering healthcare. We are willing to look past the near-term macro uncertainties to buy a leading bellwether health technology company at a reasonable valuation.

Oracle Corporation (ORCL)

(Analyst: Andy Ramer)

Description

Oracle is the number one database solutions company and the second largest software applications provider in the world. The company derived 78% of its \$37 billion in revenues from software in fiscal 2016, followed by hardware at 13%, and services at 9%. The U.S. accounted for 47% of sales in the last fiscal year.

Good Business

- The database business, as well as the applications, are difficult to displace given high switching costs, especially for large enterprises. Oracle invests a significant amount of money to support technology (with research and development approximating 15% of sales), and to maintain and grow customer relationships.
- Approximately 80% of the company's operating profit is derived from recurring sources of revenue like maintenance and cloud subscriptions. Renewal rates are high and rising.
- Return on invested capital, net of cash, was approximately 30% in fiscal 2016.
- Oracle has a strong balance sheet with net cash and marketable securities of \$5.4 billion.

Valuation

- Shares have underperformed the market on a total return basis by approximately 25% over the last five years.
- On a basis of enterprise value-to-forward twelve-month forecast earnings before interest and tax, the multiple is 12 times.
- The free cash flow yield is 6%.

Management

- Lawrence Ellison is Chairman, Chief Technology Officer, and founder. He has driven Oracle's transformation to the cloud, which began over a decade ago with the rewriting of their software. Ellison owns 27% of the company and thus brings an owner-operator perspective.
- Oracle has returned a significant amount of free cash flow back to shareholders, with shares outstanding down by over 20% since fiscal 2011.
- Co-CEO Mark Hurd is primarily responsible for sales and marketing, and Co-CEO Safra Catz manages the finances. Thomas Kurian is President of Product Development.

Investment Thesis

Oracle's transition to a cloud-based business model has been bumpy, with the shift from licenses to subscriptions pressuring profitability. However, we believe the strategy is on track, and that margins have troughed. Investor skepticism about the ultimate success of the transition has given us an opportunity to buy this high-quality and essential business at a relatively attractive price.

Thank you for your confidence in Fiduciary Management, Inc.

**Fiduciary Management Inc.
Large Cap Equity Composite
12/31/2006 - 12/31/2016**

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			
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%
2015	-1.54	-2.16	1.38	655	0.27	9.94%	10.48%	\$ 14,304.1	\$ 21,042.9	67.98%
2016	14.85	14.16	11.96	636	0.32	10.48%	10.59%	\$ 12,562.9	\$ 22,626.7	55.52%

*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 - 12/31/2016. 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 - 12/31/2016. The verification and performance examination reports are available upon request. Benchmark returns are not covered by the report of independent verifiers.

FMI was founded in 1980 and is an independent investment counseling firm registered with the SEC and the State of Wisconsin. The firm manages over \$22.6 billion in assets of pension and profit sharing trusts, mutual funds, Taft-Hartley funds, insurance company portfolios, endowments and personal trusts. The firm includes both institutional and mutual fund business. Although the firm has participated in wrap programs, it is a separate and distinct business, and is excluded from firm-wide assets.

The 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.