FIDUCIARY MANAGEMENT, INC.
Investment Counsel

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

INVESTMENT STRATEGY OUTLOOK – SMALL CAP EQUITY

March 31, 2010

The FMI small cap portfolios gained approximately 9% in the quarter ending March 31. The benchmark Russell 2000 Index also advanced about the same, driven by excellent results from technology, industrials and financials. We had relatively strong performance in the retail and commercial services segments, but lagged in the health technology and technology services arenas. Stocks that detracted from performance, including DST Systems and Molex, were offset by the strong showing in Family Dollar and Gartner. From the bottom of the market just over a year ago, the Russell 2000 has gained approximately 100%. As this bull market advances, we would not be surprised if it becomes more difficult to keep pace with the benchmark. This has been a typical pattern for FMI for the better part of 25 years; we usually do better in sideways and down markets and modestly lag the benchmark in strong up markets. We feel fortunate to have only trailed the market by a few percentage points since the bottom on March 9, 2009, but knowing today how hard it is to find high quality, cheap stocks tells us we may be due for either a breather or else a move into a higher valuation, growth stock-driven market phase. Of course, which outcome will emerge is impossible to predict.

We do know that elongated rallies often result in extended valuations. Even though earnings have recovered dramatically from a year ago, most measures of value, as articulated in our December letter, remain in the upper quartile, when viewed from a long-term perspective. While the market advance has been very broad, junk bonds and highly-levered business enterprises have had spectacular moves. At $31.5 billion, March actually eclipsed November of 2006 for the record in new junk bond issuance. These investments have benefited from the highly accommodative Federal Reserve and U.S. Government. If rates rise and the yield curve flattens, continuing its recent trend, it might not be as hospitable for these types of securities in the future.

As a reminder, our March and September letters are generally shorter and highlight a couple of our investments, while the December and June letters typically deal with topics in more depth. The top-down musings you see each quarter are interesting and useful, because they help keep the macro environment in perspective, but the money is made with good stock picking and that has always been the number one priority of the team. As a further aside, the research team at FMI has been strengthened over the past six months with two additional analysts.

The U.S. economy has continued its gradual recovery from the extremely depressed levels of a year ago. Inventories, which were depleted, are now rebounding in numerous industries. Demand for automobiles, while nowhere near 2007 levels, is improving. Durable goods orders advanced for the third straight month recently, although construction demand remains depressed. Demand for electronics and semiconductor components grew nicely over the past six months and order books are reasonably healthy. Demand for technology consulting also appears to be growing, which foreshadows better hardware and software sales down the road. Surprisingly, retail sales have been higher than expected, despite relatively low consumer sentiment figures. Banks and other financials have been huge beneficiaries of the Fed's zero percent interest rate policy and a steep yield curve. Many of the banks have paid back borrowed TARP funds and we gladly eat our words regarding the bank portion of the TARP bailouts. That said, it remains to be seen how the mortgage interventions and the massive monetary easing policies will play out in the long run.

Housing remains very difficult. New home sales recently touched 308,000, the lowest figure since records have been kept (1962). Currently there are 3.25 million homes for sale and an additional 5-5.5 million that are in late stages of delinquency or early foreclosure, presenting a huge overhang of inventory. Foreclosures have worsened for seven consecutive quarters and foreclosure rates are still near record highs, despite the government's mitigation efforts. Fannie and Freddie, the de facto housing authorities (together with the Federal Housing Administration and Veterans Administration, these government agencies are funding over 90% of new mortgages), remain an absolute disaster from a credit quality standpoint. Nonperforming loans recently totaled over $317 billion within these entities. Moreover, the FHA is essentially broke and will need additional taxpayer assistance. The administration recently unveiled yet another housing bailout plan, despite abysmal results for the plans advanced so far. Sixty percent of the borrowers who took advantage of the first loan modification plan in the fourth quarter of 2008 have redefaulted, according to the Office of the Comptroller of the Currency. Despite a 31% drop in home prices from the peak, according to Case-Shiller, home prices remain 28% ahead of the Consumer Price Index over the past two decades. We continue to believe that housing will take several years to get back into a healthy state. Furthermore, we really don't understand why so many people seem to think that home ownership is a birthright. Promulgating policies that encourage uncreditworthy people to own homes hurts everybody. What's wrong with renting?

Unemployment remains very high with just a dollop of improvement coming from temporary hours and hiring sentiment. Fear of greater mandates (health care), regulatory burdens (environmental) and taxes continue to concern the business community. Corporate executives express frustration with what appears to be an anti-business stance by Congress and the administration. This has to ameliorate before a meaningful employment recovery can begin.

Of course, the elephant in the room is the U.S. debt load and the staggering annual deficit, which is now $1.4 trillion and rising. The recent health care bill will likely add significantly to a deficit that is already running over 40% of the budget. Except for the smallest companies, if an employer is paying $10,000 for an employee's health benefit and is going to be fined $2,000 for not providing coverage, it is pretty easy to see what is going to happen. This is a public option in drag. Trying to fund it with punitive taxes on "high earning" individuals will likely result in the usual outcome when tax rates are raised: less-than-expected tax income generated. High-income workers will take tax mitigating steps such as delaying capital gains, shifting to municipal bonds from corporates, shifting their tax reporting structure, opting for leisure, etc. It's essentially a foregone conclusion that the current $12 trillion debt load, which doesn't even account for unfunded Social Security benefits and other "off-balance sheet" obligations, is going to rise significantly. At some point, it simply becomes too much. We may be at this juncture today. If interest rates stay low (not likely in our opinion), the debt service pain may be manageable. If rates rise significantly, the burden could be severe.

Major foreign economies are mixed, which is not unusual. Japan remains weak and heavily indebted, despite running large trade surpluses. Brazil and some Asian countries, including India, have recovered nicely from the trough. Global trade has bounced back, particularly in the emerging Asian economies. Western European economies, however, are struggling with many of the same fiscal woes as the United States. Deficits have ballooned in the United Kingdom and across most of the Continent, as generous welfare and public employee benefits meet tax revenues that are depressed. The European Union and the common currency regime are being stretched thin by Greece and other countries with particularly high deficits and poor economic performance. Germany is being asked to sacrifice for the sake of the Union and the Euro, but politically that is very unpopular. Angela Merkel, Germany's Chancellor, is trying to drag the International Monetary Fund (IMF) into a bailout of Greece (and likely Portugal). Should this come to pass, the United States would take yet another hit, as we are the biggest contributor to the IMF.

The China economic miracle continues, seemingly uninterrupted by the events of 2008-2009. While the long-term outlook for China remains positive, owing to its strong work ethic, cheap labor and educational achievement, we've become more skeptical of the near-term situation. China's "aggressive mercantilism," as some call it, is obviously constrained if the demand for Chinese goods is weaker. With the U.S. and Western Europe on a lower growth plane, China needs other countries (including itself) to increase consumption of Chinese-made goods. Moreover, huge infrastructure expenditures had a correspondingly large positive economic impact, when China was capital-starved. Productivity expanded dramatically. Today this is not the case, yet China continues to use the old playbook, spending massive government funds on projects with suspect economic value. Real estate prices have escalated dramatically and there are eerie signs of property bubbles in many of the bigger cities, even while reports keep coming back highlighting large numbers of empty high rise apartment buildings and idle plant capacity. The government's apparent orchestrated effort to thwart foreign joint venture partners and tilt the playing field in its favor is worrisome and may be the manifestations of a country that sees their GDP growth trajectory falling. Again, we view this more as a short-term risk than a long-term structural change. If worldwide economic growth recovers more rapidly in the next year or two, there might not be much negative fallout.

Some U.S. economists and government leaders seem to be blaming China for our economic shortcomings and are pushing China to revalue their currency (one Nobel Laureate suggested by 25%). It is hard to know for sure whether such a policy would help the United States (historically, so-called beggar-thy-neighbor policies have not been effective), and as John Mauldin, the thoughtful writer of the *FrontLine Newsletter*, pointed out recently, Japan has been pressured to revalue their currency for much of the past forty years. In 1971, the yen was 350 to the dollar and Japan ran trade surpluses. Today the yen is under 90 (a 75% rise) and Japan is still running trade surpluses with the

U.S. Japan is obviously still selling goods (even at much higher prices) that we desire. Given the large advantage China has in labor and their willingness to run at lower profit margins, it is hard to imagine anything but a dramatic revaluation making a dent in our trade deficit. What may be more likely, if the peg is removed and the yuan floats higher, is China exporting inflation to the United States (assuming Chinese companies raise prices to offset the currency hit). The U.S. may want to heed the Chinese proverb: "Be careful what you wish for. It may be granted."

Globalization has made it necessary for us to spend more of our time analyzing foreign events, economies and industries. Most of our companies compete worldwide and a few have greater shares of revenue and earnings coming from abroad than from the U.S. Ironically, this isn't the case with the two companies below, PICO Holdings and W.R. Berkley Corporation, but since they are relatively new to the portfolio, we wanted to highlight them. The research team has identified a number of other companies that look promising, but we are being patient with respect to valuations.

PICO Holdings, Inc.

Description

PICO Holdings, Inc. is a diversified holding company. PICO seeks to acquire, build, and operate businesses where significant value can be created from the development of unique assets, and to acquire businesses that the company identifies as undervalued and where management participation in operations can aid in the recognition of the businesses' fair value, as well as create additional value. Currently PICO's two major businesses are Vidler Water Company, a significant private sector owner of water resources and water storage operations in Nevada, Arizona, Idaho, Colorado, and New Mexico, and Union Community Partners, a developer of residential lots in selected California markets.

Good Business

- PICO's competitive advantages include its industry and operational expertise, financial wherewithal, and ability to engage key decision makers.
- Water is a critical asset that has no substitute, and the cost to the end user is relatively small.
- The financial metric for any asset or business that PICO acquires is that it has to have a minimum internal rate of return (IRR) of 20% unleveraged.
- The businesses are easy to understand.
- Cash totals $96.8 million net of debt. Due to PICO's financial structure, it is under no pressure to sell any asset at less than full value.

Valuation

- PICO is trading for 1.43x book value of $25.79 per share. This is a slight premium to the 5-year average multiple of 1.33. The only time the stock dropped well below 1.0x book during this 5-year stretch was during the recent market turmoil in December 2008 (0.58) and March 2009 (0.74) quarters.
- The company's water and real estate assets are carried at cost. The majority of these assets was either acquired well before the run up in asset prices or after the decline in residential real estate was well underway, and at substantial discounts to current replacement values. In addition, value has been added as a result of PICO's development efforts for some assets. Marking the water and real estate assets to market gives us a value of $52 per share. Thus, the shares trade for 70% of adjusted book.

Management

- Company founder and board member Ron Langley, 65, and President and CEO John Hart, 50, are disciples of Graham and Dodd.
- The management bench is deep, many of whom were groomed by Langley. Through a combination of team-oriented culture and attractive compensation, PICO has been able to retain key employees and preserve institutional knowledge.
- Max Webb, 48, is CFO. Rich Sharpe, 54, is COO. Damian Georgino, 49, is Executive Vice President of Corporate Development and Chief Legal Officer.
- Annual incentive awards are designed to motivate executive officers to increase PICO's book value per share.
- Executive officers and directors as a group own 4.7% of the company, so they have skin in the game.

Investment Thesis

As a developer of water rights in the southwest U.S., PICO is poised to benefit from the increasing scarcity of water. PICO has also taken advantage of a collapse in California residential real estate prices, by acquiring developable land and partially developed and finished lots in attractive medium-sized markets. Furthermore, the company's water and land assets are undervalued on the balance sheet. By virtue of its ownership of these hard assets, PICO should be a beneficiary of inflationary pressures, which is a likely byproduct of the government ramping up the printing presses.

W.R. Berkley Corporation

Description

W.R. Berkley is an industry leading multi-line property and casualty insurance company. The firm operates five main segments: Specialty (38% of net premiums), Regional (29%), Alternative Risk (15%), Reinsurance (12%), and International (7%). The company's reputation for prudent underwriting and astute investment acumen has produced one of the industry's strongest return-on-equity (ROE) track records. The majority of policies are focused on small- to middle-market commercial risks with retention limits of $1 million.

Good Business

- Berkley holds a dominant position in a number of specialty niche markets. The company's unique decentralized operating structure and compensation policies provide the proper incentive to retain talent and deliver top-tier solutions. The casualty focus of Berkley's business generates attractive float income, relatively non-correlated risks and an efficient use of capital.
- Their products are economic necessities.
- Berkley generates full-cycle ROE comfortably above its peers and the market. Over the trailing 10 years the business has generated a 17% average ROE, with book value expanding by 17% annually.
- The company maintains a conservative balance sheet with debt-to-total capital of 26%. Standard & Poor's and A.M. Best rate Berkley A+.
- Berkley is substantially underlevered, with approximately $500 million of excess capital and meaningful investment positions in low yielding cash.
- The company's current premium-to-surplus ratio of 1.1 can expand to 2.0 in a hard market, effectively growing the company's business by 80% without the need for any additional capital.
- Over each of the past three years, Berkley has generated approximately $1.6 billion in operating cash flow.
- This is an easy business to understand.

Valuation

- The stock is approximately 37% below its all-time high.
- Over the past 10 years, Berkley has traded for an average price-to-book value (P/BV) multiple of 1.6, ranging from just below today's 1.0 multiple to 3.0. The stock would have to advance 60% to reach its average P/BV.
- The industry is also depressed and all players should benefit from a revaluation when the economy gets healthier.

Management

- Bill Berkley is W.R. Berkley's founder, Chairman and CEO. He owns 15% of the company's outstanding equity.
- Executive compensation is tied to ROE and 5-year growth in book value per share.
- Outside of the CEO, executives own an average equivalent of 8.5 times their salary in stock.

Investment Thesis

Berkley's shares have lagged the broader market, as investors anticipate yet another year of soft industry pricing. Berkley is a high-quality franchise with significant excess capital, low leverage, and a conservative balance sheet. The company trades at a significant historical discount despite unsustainable lows in major external drivers (units, pricing and interest rates) of its business. Over time, the company's decentralized specialty underwriting businesses will continue to generate industry-leading returns.

Thank you for your confidence in Fiduciary Management, Inc.

Fiduciary Management Inc.
Small 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	20.42	19.57	2.49	125	1.88	$ 587.2	$ 1,458.2	40.27%
2002	-4.78	-5.46	-20.48	154	1.47	$ 649.7	$ 1,731.0	37.53%
2003	27.18	26.22	47.25	167	1.93	$ 1,206.9	$ 2,927.0	41.23%
2004	20.92	20.02	18.33	181	1.00	$ 1,486.6	$ 3,085.8	48.18%
2005	11.12	10.26	4.55	186	0.69	$ 1,605.8	$ 3,174.4	50.59%
2006	18.46	17.56	18.37	147	0.73	$ 1,606.8	$ 3,589.4	44.77%
2007	-0.92	-1.72	-1.57	161	0.85	$ 1,520.2	$ 3,960.4	38.39%
2008	-21.06	-21.69	-33.79	145	1.16	$ 1,212.4	$ 4,062.5	29.84%
2009	35.72	34.56	27.17	165	0.97	$ 2,004.6	$ 7,008.9	28.60%
2010	23.45	22.43	26.85	170	0.48	$ 2,477.7	$ 9,816.0	25.24%
Q1 2011	7.18	6.96	7.94	182	0.19	$ 2,699.2	$ 11,338.0	23.81%
Q2 2011	1.16	0.96	-1.61	179	0.11	$ 2,718.9	$ 11,819.6	23.00%
Q3 2011	-16.12	-16.29	-21.87	178	0.31	$ 2,188.9	$ 10,357.9	21.13%

*Benchmark: Russell 2000 Index®

Effective January 2012, 2004 – 2011 gross and net composite returns and dispersion 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 Small Cap Equity composite has been examined for the periods 12/31/1993 - 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 Small Cap Equity Composite was created in January 1980. These accounts primarily invest in small to medium capitalization US equities.

The FMI Small 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. A small percentage of composite assets (typically ranging from 0-5%) historically has been invested in unmanaged fixed income securities at the direction of account holders. From December 31, 1993 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 Small Cap Equity Composite portfolios is as follows:

Up to $25,000,000	0.90%
$25,000,001-$50,000,000	0.85%
$50,000,001-$100,000,000	0.75%
$100,000,001 and above	0.65%

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 Russell 2000 Index® measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index representing approximately 8% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. The Small Cap Equity composite uses the Russell 2000 Index® as its primary index comparison.