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

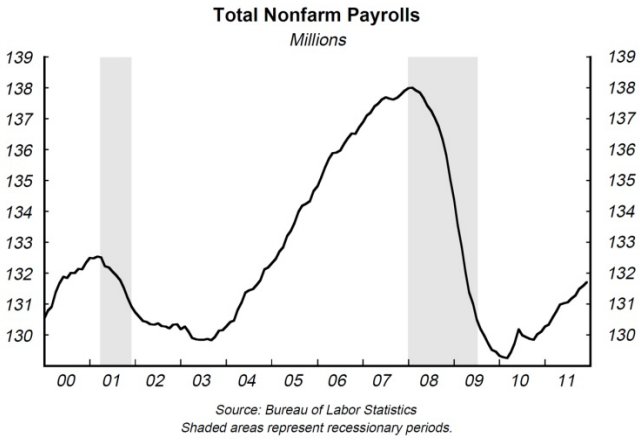
Quarter Ended December 31, 2011

FMI small cap portfolios returned approximately 16.1% in the December quarter compared to 15.5% for the benchmark Russell 2000 Index. Cash, Process Industries and Industrial Services were negative contributing sectors. Relative to the large capitalization indices, valuations in the small cap arena remain unattractive and we have struggled to find strong franchises at cheap prices. This gave rise to higher than normal cash which we have now worked down to approximately 7%. Sigma-Aldrich and Bemis detracted from performance in the quarter. On the positive front, Non-Energy Minerals, Producer Manufacturing and Finance added to our results, driven by Eagle Materials, Carlisle, and Protective Life. For the calendar year, the portfolios gained approximately 5.6% compared to negative 4.2% for the Russell 2000 benchmark. Despite this satisfying comparative performance, 2011 was a frustrating year from a big picture standpoint.

The anxiety and unease of the people can't seem to be shaken. Why?

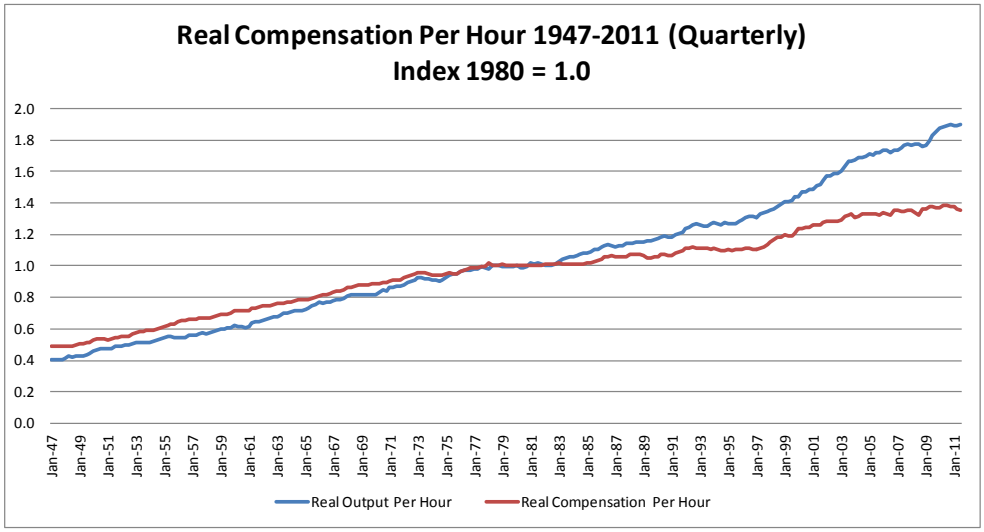
It is more than the fact that the United States, Europe and Japan have piled on debt and long-term obligations that cannot realistically be funded. It is more than our inability to decide what to tax or what to cut in order to put our collective fiscal houses in order. It is more than the deep-seated knowledge that spending more money that we don't have can't possibly be the solution to overspending in the first place. It is more than knowing that growing central bank balance sheets (a.k.a. quantitative easing) simply devalues our currency. It is more than the anger that comes with knowing that most of the major commercial and investment banks are even larger today than the last time they were considered too big to fail, thereby requiring taxpayer bailouts. It is more than the recognition that the wars in Iraq and Afghanistan have come at great human sacrifice, have been enormously expensive and sadly, have been largely ineffectual. It is more than the realization that our houses are expenses rather than investments. It is more than the understanding that equities (as measured by the popular indices) have been running in place for more than a decade.

The underlying angst seems to be centered primarily on employment. Of all the economic variables, geopolitical statistics, budgetary items and market figures, nothing compares to the importance of work and getting paid for it. Today's total U.S. employment, 131.5 million, is the same as it was eleven years ago, while over this time the workforce is at least 13 million higher and population is 28 million greater. There are upwards of 24 million people unemployed or underemployed. While there are certainly some government policies that influence employment (the extension of unemployment benefits, payroll taxes, visas, immigration, etc.) as well as public policies affecting business formation, it appears the current cyclically high unemployment is being exacerbated by underlying secular factors.



What is lost in the current conversation about Keynesian stimulus, relative tax rates and access to credit is that to some extent, what is "happening"

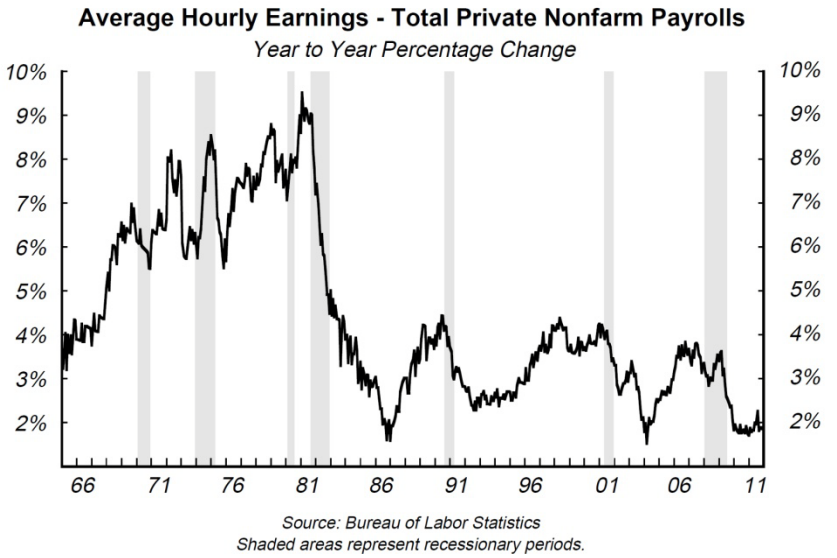
to Americans reflects forces beyond our control. Real wages and benefits grew significantly for roughly forty years following World War II. The United States took advantage of its abundant resources, population growth and educational system to dramatically improve labor productivity, increase income and raise the standard of living. The domestic market was large enough to sustain this virtuous cycle. Real compensation grew 89% from 1950-1980. On a purchase power parity basis, the U.S. enjoyed not only a huge advantage over developing countries, but also an edge over other developed nations, who experienced this same phenomenon, but not to the same extent. Most second and third world countries faced structural problems, including deficient property rights, shaky legal systems, closed markets, corruption, and poor access to capital. This started to change in the late 1970s, particularly in China, when Deng Xiaoping instituted economic reforms following the death of Chairman Mao. While it would take a couple of decades for China to become a real economic force, countries such as Taiwan and Korea started to exert pressure on U.S. labor markets in the 1980s and 1990s. As the following chart illustrates, real compensation per hour began to flatten out in the 1980s and has been on a much lower growth path since. From 1980-2010, the growth rate declined to 37% from the prior thirty years' 89% pace.



Source: Federal Reserve Bank of St. Louis

Most of us remember the wrenching turmoil the domestic automobile industry experienced in the 1980s as the quality and value of Japanese autos improved and their exports soared. U.S. automobile employment shrunk significantly and would never recover. This was, however, just the beginning as manufacturing in a vast array of industries was starting to be transformed. Cheap communications, inexpensive plant construction and operating costs, advanced software and logistics, and expensive U.S. labor costs were the catalysts in this phenomenon. While we've all enjoyed the wonderfully innovative and low-priced products globalization has created, it has come at a cost to the U.S. manufacturing base. Manufacturing employment went from 18.7 million in 1980 to 11.5 million in 2010. That is in a country whose population has grown to over 300 million from 226 million in 1980. Aside from manufacturing, the information technology industry has also been transformed. Cheap communications and well-educated English speaking foreigners from India and elsewhere brought additional pressure on both jobs and wages for many U.S. technology workers. Years ago we discussed these issues in the context of world wage disintermediation and "the China price" along with the impact it was having across a broad spectrum of companies. This is not a new trend and there is no way to say for sure it has run its course.

As the accompanying chart shows, if nominal wage growth remains low (today it is less than 2%), real wages will run negative as long as the inflation rate is above 2%. Indeed, real per capita income in the United States today is approximately $32,000, which is about the same as in December of 2004. Emerging market real wages, on the other hand, have grown significantly. What we are feeling is a loss of relative ground. It is painful and right now it seems like there is no end in sight. The transformation of the developing world, however, has been rapid. Eventually, as standards of living converge, real wages will start to pick up in the U.S. We can certainly help this along with positive tax, immigration, and spending policies, as well as the continuing push for better K-12 education.



It is our contention that a meaningful part of the transformation may already have played out. Wages have been growing very rapidly in China, Brazil, India and other developing countries, and corporations have also come to understand that supply chain, intellectual property and quality issues can have an enormous impact on the outsourcing decision. We are seeing an increase in the "reshoring" of businesses that had formerly gone overseas. In a recent study, the Boston Consulting Group estimated that as many as 3 million jobs will be created by 2020 from the reshoring of overseas jobs. The downward curve seems to be flattening, although this is hard to discern because of the depth of the current cycle. If there is a worldwide recession or financial panic, it probably delays the onset of any sort of equilibrium.

Imagine, for a moment, if we viewed the employment issue from a different angle, perhaps from that of a global sociologist. According to the World Bank, from 1994-2005, 572 million people escaped poverty in China. 98 million Indians accomplished the same thing. We cannot find reliable data for the past six years, but various authors have suggested over a billion people in the developing world have escaped poverty over the past two decades. The Asian Development Bank reports 273 million Indians are now in the middle class and we've seen higher figures for China. It may be one of the most remarkable achievements mankind has ever seen. That the people who accomplished this have better lives is rather obvious, but what will be their benefit to the rest of the world over the next thirty years and beyond? What will be the value of another billion people surmounting this hurdle? How many products, innovations and services will these two billion people undertake? Will there be two billion more people who have time and perhaps some resources to push for democracy or at least additional freedoms? Will two billion more people conclude they have something to live for and perhaps be disinclined to engage in harmful activities? What if the global sociologist concluded that the loss of 10-30 million jobs in the developed world was the cost to jump-start the transformation of Asia and the developing world? One might conclude that this was a small price to pay. In a period of such pessimism in the developed world, it is important to take inventory of how much better off the whole world is today compared to a decade ago.

Naturally, there are plenty of prognosticators on the other side of this issue, who believe that the rapid relative growth of the developing world will continue to suppress wages and employment in the developed world. That little employment or wage growth took place in the 2010-2011 recovery is certainly disconcerting, but perhaps

the extreme budget and debt issues that have dominated the landscape have resulted in unusual caution on the hiring front.

Recently, stock markets have been highly volatile and unable to sustain solid returns. Economies have likewise struggled. Across the developed world, people can't bring themselves to the understanding that things may be permanently changed. They want back their old job and old benefits. They want back the money lost in their houses, they want back their stock market and currency losses, and they want back their old retirement plans. It isn't likely to come back, regardless of who is in charge. It's surprising to see the number of private sector workers that stand in solidarity with protesting public sector workers considering what has transpired over the past sixty years. Federal public sector total compensation in 1950 was 119% of private sector total compensation. By 2010 it was 201%.

Total Compensation - BEA.gov Table 6.2 B,C,D / 6.5 B,C,D	1950	1960	1970	1980	1990	2000	2010
Private Industry Employees FT Equivalent	41,099	46,103	56,554	70,958	85,602	104,283	100,539
Federal Civilian Employees FT Equivalent	1,417	1,704	1,959	2,069	2,221	1,869	2,091
Private Industry Total Compensation	131,318	243,031	484,984	1,316,382	2,645,335	4,773,287	6,309,507
Federal Civilian Total Compensation	5,401	11,106	23,429	58,228	103,268	142,394	263,760
Private Industry Compensation/Employee	$ 3.20	$ 5.27	$ 8.58	$ 18.55	$ 30.90	$ 45.77	$ 62.76
Federal Civilian Compensation/Employee	$ 3.81	$ 6.52	$ 11.96	$ 28.14	$ 46.50	$ 76.19	$ 126.14
Federal Civilian Comp as % of Private Industry Comp	119%	124%	139%	152%	150%	166%	201%

Following is an updated table we first published in June of 2010. Since 1965, spending on payments for individuals, or entitlements (64% of the U.S. budget) has grown at a 9.9% clip. Since 1985, the growth rate has been 6.9%. Population and inflation have grown at a 1.4% and 4.4% rate, respectively, since 1965 and a 1.2% rate and 2.9% rate, respectively, since 1985. Defense spending (20% of the budget) has grown at a 6% rate since 1965 and a 4.1% rate since 1985.

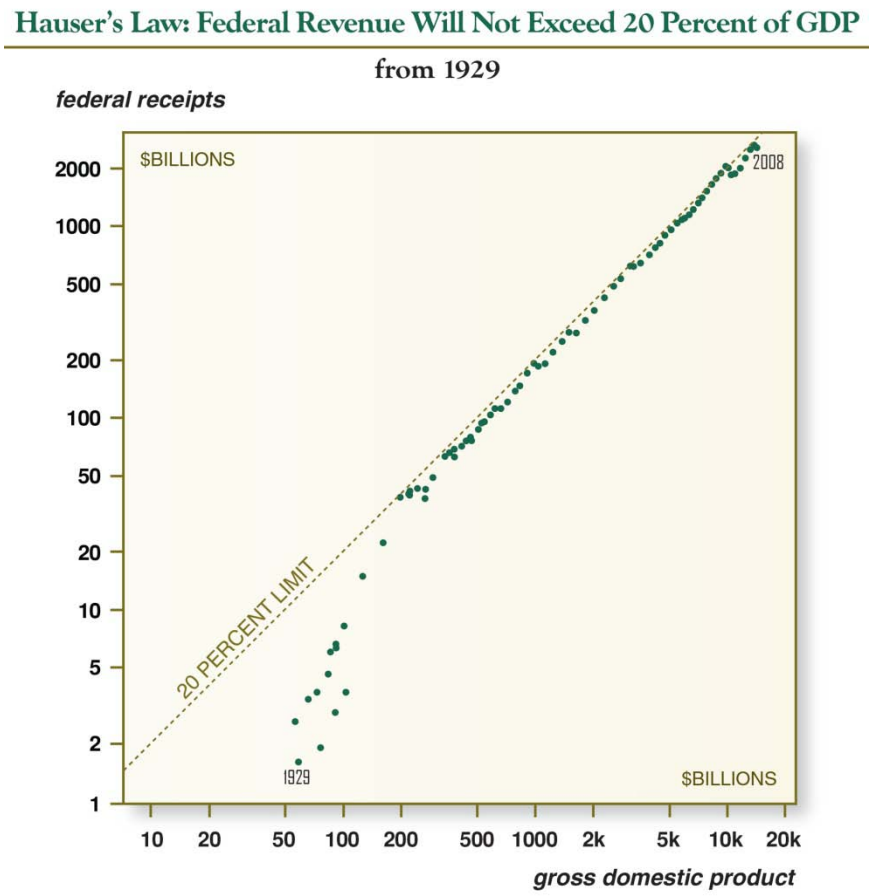
	Annualized Growth 1965-2010	Annualized Growth 1985-2010
Inflation (CPI)	4.4%	2.9%
Population	1.41%	1.16%
Social Security	8.5%	5.4%
Medical Care	14.7%	8.8%
Federal Employee Retirement	8.1%	4.9%
Public Assistance (PA) and Related Programs	8.5%	8.2%
Other PA (Unemployment, Students, Housing, Food, Other)	10.7%	7.6%
Total Payments for Individuals	**9.9%**	**6.9%**
National Defense Spending	6.0%	4.1%

No government can continue to pay benefits or spend on national defense at a rate that exceeds the underlying growth of the economy or the private sector's ability to generate tax revenue. The people standing to lose are angry and they want to blame somebody (the rich). This accomplishes little and if the sentiment is left unchecked, it could take the country on a dangerous path. In the March 2011 letter we articulated the fact that there are only 321,294 people in the U.S. making more than a million dollars in income.[1] We could increase taxes on this group by 50% and raise only $130 billion, which is 8.7% of 2011's deficit and less than 1% of the total government debt and this assumes these high earners don't take any mitigating actions (defer or

[1] The IRS data is for 2008, the most recent available. Actual millionaires may be slightly higher in the cases where both spouses earn over $1 million and are filing jointly.

hide income, delay capital gains or opt for leisure). Applying the same formula down to the 4.4 million people earning more than $200,000 would generate only $272 billion in revenue, less than 20% of the annual deficit.

The accompanying chart reprinted from the same letter shows very clearly that over the past eighty years, it has been virtually impossible to raise more than 20% of GDP, regardless of the tax rate.



There are certainly no easy answers, but one has to recognize that spending is far too high. Loopholes and deductions also have to be eliminated. Tax policy should be simpler and flatter, with no ability for high income earners to pay a lower rate than people beneath them. We feel the stock markets will not achieve lasting improvement until governments prove they can spend within their means. Business people are going to be reluctant to make capital and labor investments unless they feel the system will be sound for the long haul. Unlike Keynesians, who believe government spending cuts will result in declining economic growth, we believe the opposite. While there might be some very short term impacts from reduced government outlays, it is our sense from talking to many corporate leaders and private business people that they are poised to hire and invest, once they sense the country is on a sound and sustainable fiscal path.

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Sometimes it is interesting to view things from a very long term perspective. On a cumulative basis over the past thirty years, inflation was 140.9%. Gold is up 293.4%. Home prices appreciated by 191% (through October). The Russell 2000 Index gained 1556.7%, generating a compound annual return of 9.8%. FMI small cap portfolios, gross of fees, grew 4582.9%, for a compound annual return of 13.7%.[2] These results have been achieved while taking less risk than the market, at least as measured by volatility of returns. While small-to-mid cap stocks in general are not especially inviting right now on a valuation basis, we feel the FMI small cap portfolios trade at a reasonable level of approximately 13 times 2012 earnings.

Thank you for your support of Fiduciary Management, Inc.

[2] Inflation calculated from 12/31/1981-11/30/2011. Gold, Russell 2000 Index, and FMI Small Cap Composite performance calculated from 12/31/1981–12/31/2011.

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.