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INVESTMENT STRATEGY OUTLOOK – SMALL CAP EQUITY

September 30, 2013

The FMI Small Cap portfolios gained approximately 10.1% in the September quarter compared to 10.21% for the benchmark Russell 2000 Index. Stock market sectors aiding relative performance included Producer Manufacturing, Energy Minerals and Finance. In addition to abnormally high cash levels, sectors hurting relative performance included Health Technology, Process Industries and Distribution Services. Both Kaydon and Molex were acquired at significant premiums in the quarter and proceeds have not yet been redeployed. Compass Minerals declined in the period but we remain constructive on its prospects. McDermott also hurt performance in the September quarter and our reevaluation of its long-term outlook led to its removal. The year-to-date gain of the small cap portfolios and the Russell 2000 has been spectacular, continuing an unusual and almost unbroken run from the March 9, 2009 lows. Since that time, the portfolios are up approximately 229% (gross) and the Russell 2000, up 233%. As an aside, we are satisfied to have only modestly lagged during this remarkable period, as our conservative style doesn't lend itself to keeping up in a runaway market. Today, we feel the benchmark Russell 2000 is loaded with overpriced and speculative merchandise. If, however, that index continues to soar, we will undoubtedly lag.

According to statistics compiled by the Leuthold Group, the gain in the stock market over the past four and half years is roughly double the median gain of the 15 bull markets since 1929. The composite of the approximately four dozen different valuation measures that we monitor quarterly dipped to the 5th decile in early 2009 and is now in the 8th decile (the 10th decile being the most expensive). Moreover, as mentioned in last quarter's letter, the broad expansion of multiples across the vast majority of sectors leaves most median valuation measures equal to or higher than what existed in the 1999-2000 tech/telecom/internet bubble top. Additionally, the underlying fundamentals of the U.S. and European economies are sluggish, while the BRIC countries (Brazil, Russia, India and China) have seen slowing. While some individual companies are thriving, on average they are either in slow growth mode or are stagnant. The overriding determinant of recent and expected near-term performance appears to be monetary policy, specifically easy money. This policy, in our opinion, is largely experimental and has already artificially inflated assets across a broad spectrum; it grossly misallocates resources, makes "the rich" richer (they own the inflating assets, not the middle class), has little "wealth-effect" on spending and long-term, could potentially spur difficult–to-control inflation.

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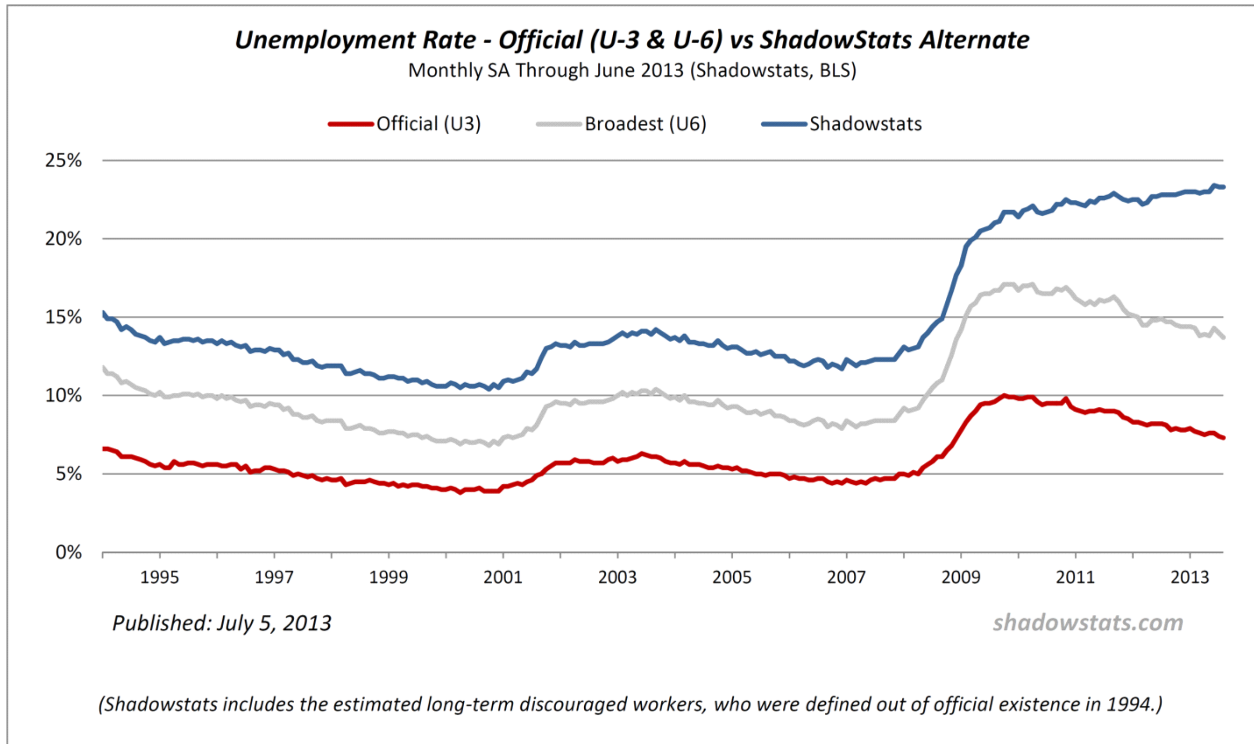
Economic Growth and Labor

The U.S. economy remains stuck in a pattern of very low growth. The current Bloomberg estimate for 2013 real GDP growth is 1.6%. This recovery has averaged about 2% growth, which is less than half

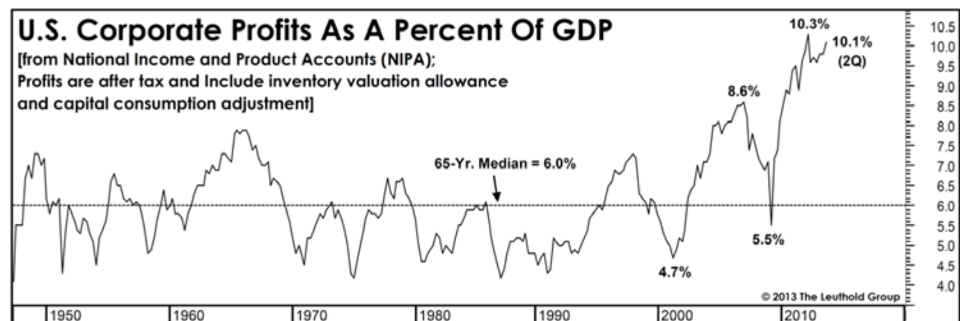
that of a normal recovery. Real wages have been falling. Labor Department data shows that adjusted for inflation, average hourly pay has declined 0.9% since the end of the recession in 2009. The headline unemployment rate of 7.3% has fallen, but the broader official Bureau of Labor measure of unemployment and underemployment, U6, shows a 14% rate. Remarkably, including people who are “long-term” discouraged, the figure is unofficially approximately 23% and has actually been rising during this so-called recovery, as can be seen in the chart below. A startlingly high number of people appear to be simply giving up their job search. This is unprecedented in the post-WWII period and reflects just how broken the job creation machine has become.



The labor participation rate continues to fall and is at a multi-generational low of 63.2%. Weak labor figures, combined with tepid capital formation, virtually doom the economy to slow growth. The last decade has been one of the slowest periods of fixed business investment as a percentage of GDP in the past six decades. After the initial spike off the 2009 bottom, sales and earnings growth for corporations has dropped significantly. According to the Leuthold Group, twelve month trailing Standard & Poor’s 500 Index earnings per share (EPS) are $89.18, essentially flat from the fourth quarter of 2011.

Profit Margins

The fourth quarter of 2011 turned out to be the peak quarter of profitability in this cycle. Corporate profits reached 10.3% compared to the prior high of 8.6% (see chart). Today margins stand at 10.1%.



The Leuthold Group points out that contrary to what the experts believe, most of the margin expansion over the past fifteen years is not due to dramatic increases in corporate efficiency or outsourcing manufacturing to lower labor cost countries, but rather, decreases in interest rates and corporate taxes. Below is a table breaking out the difference between 1997 margins and 2013 margins. Net interest payments as a percent of sales dropped from 4.8% to 2.7%. Corporate taxes dropped from 2.9% to 2.5%. Indeed, a look at EBIT margins (earnings before interest and taxes), shows an increase of only 20 basis points since the tech era profitability peak.

Margin Expansion:
From The Late 1990s Profitability Peak To Today

NIPA Income Statement	1997:Q3	2013:Q2
Earnings Before Interest & Taxes As Pct. Of "Sales" (i.e., GDP)	15.1%	15.3%
Net Interest Payments Pct Sales	4.8%	2.7%
Corporate Income Taxes Pct Sales	2.9%	2.5%
Net Corporate Profit Margin	7.3%	10.1%

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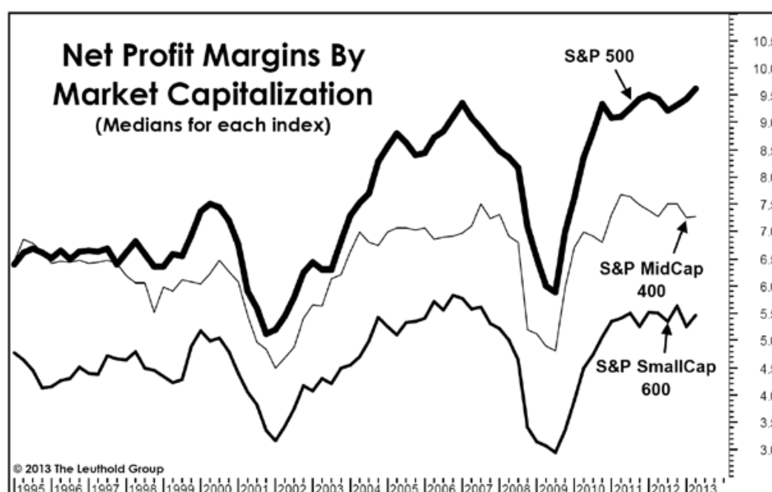
Long-term interest rates have already moved sharply off the bottom. The 10-Year Treasury yield was 1.62% a year ago and now sits at 2.63%. This compares to the median rate of 5.95% since 1957. Corporate tax rates do not appear to be going higher, but the absence of a decline will make for more difficult comparative earnings growth rates. Unless there is a magical gain in revenue growth or productivity, it certainly looks like profit margins are headed lower. EPS growth is obviously going to be difficult given this backdrop.

The margin data cited above are aggregate figures compiled by the National Income and Product Accounts (NIPA). It is also interesting to note how the margin picture looks based on company size. To the right is a graph of the three S&P 500 indices (S&P 500, S&P MidCap 400 and S&P SmallCap 600). In recent periods the smaller cap companies' margins have significantly lagged their bigger cap brethren. Additionally, smaller cap companies' historically superior earnings growth rate has virtually disappeared over the past decade. Yet despite much lower relative growth and thinner margins, as well as being less liquid, small cap stocks continue to trade at a significant premium to large cap stocks. These realities, combined with great difficulty finding small caps that fit our fundamental and valuation criteria, leave the portfolio with higher-than-normal cash and a greater-than-normal aggregate market cap.



The Stock Market

In spite of weak underlying fundamentals, the stock market continues to move higher. Words of caution are increasingly viewed with snobbish derision, as bullish investors become more emboldened by the day. Enormous faith has been put in the hands of our monetary and fiscal authorities and the minute any unpleasantness surfaces, they are expected to provide easy money or delay budgetary discipline. They have obliged (including the highly politicized sinking of the nomination of Lawrence Summers to lead the Fed, virtually handing the nomination to one of the most dovish Fed members). This self-fulfilling prophesy creates unreal expectations, which is currently manifested by high valuations. It is hard to imagine that the policy mistakes that led to the bubble of 2004-2007 could be repeated so soon. As mentioned earlier, our quarterly composite of 48 different valuation measures has moved into the 8th decile, reducing the downside protection

for the market. One of the most difficult aspects of this market is the widespread lack of value. Normally, even in a bull market, there are a number of sectors that get beaten up, giving long-term investors opportunities to make contrary bets. These sectors are few and far between presently. Our stocks trade at a significant discount to the benchmark, but remain above average from an absolute historical perspective. We have an extensive list of terrific and durable business franchises we would like to own in the event their stock prices decline significantly. History shows markets to be much more volatile and varying than they have been over the past four years. We are ready for a return to volatility!

Below we highlight two investments.

Broadridge Financial Solutions (BR)

(Analyst: Rob Helf)

Description

Broadridge Financial Solutions is a leading provider of investor communications and technology-driven processing solutions to banks, broker dealers, mutual funds and corporate issuers. Broadridge has significant market share in proxy distribution, proxy vote tabulation and other important communication as it sits between issuers and investors. The company serves over 800 bank customers, representing over 13,000 issuers. Additionally, the company provides securities transaction processing (order capture and execution, trade confirmation, settlement and accounting) and outsourcing for broker dealers and banks.

Good Business

- Broadridge provides a necessary service to public companies and the investment community.
- The company is a market leader by a wide margin in its core business of providing distribution and processing services in a highly regulated part of the financial service sector. The company's technology is facilitating the move to electronic proxy and potentially greater participation in the proxy process.
- Broadridge has a high degree of recurring revenue, high customer retention rates and a scalable business model.
- The company expects to increase margins from already respectable levels.
- The business generates an ROIC (return on invested capital) of 15-16%, which is well in excess of its cost of capital.
- Broadridge produces very strong and highly predictable levels of cash flow. Free cash flow has exceeded net income by $30-50 million per annum over the past decade.
- Broadridge returns capital to its shareholders. In the most recent quarter, the company repurchased 3.3 million shares and increased its dividend by 17%. The current $0.84 annual dividend yields 2.7% and the payout ratio approximates 40%.

Valuation

- The company is currently valued at approximately 15 times EPS (earnings per share), 8.2 times EBITDA (earnings before interest, taxes, depreciation and amortization) and 1.6 times sales. These metrics compare favorably to the general small and mid cap universe that currently trades at least 30% higher.
- Based on where similar businesses have been acquired, Broadridge appears to be trading at a significant discount to the current stock price.

Management

- Leslie Brun, age 61, is Broadridge's Chairman and has served on the Board of Directors since 2007. Mr. Brun has served as a director of ADP (former parent of Broadridge) and as ADP's Chairman since 2007.
- Richard Daly, age 60, is Broadridge's CEO and has been a member of the Board of Directors since 2007. Prior to the March 2007 spin-off of Broadridge from ADP, Mr. Daly served as Group President of the Brokerage Services Group of ADP.

- John Hogan, age 64, is Broadridge's President and COO. Prior to the spin-off, Mr. Hogan served along with Richard Daly as Group President of Brokerage Services.
- Dan Sheldon, age 56, is Broadridge's Corporate VP and Chief Financial Officer.

Investment Thesis

Broadridge has a very attractive recurring revenue business model with high ROICs and significant barriers to entry. The company should be able to grow revenues 4-5% organically and earnings at 10%, which compares favorably to the overall market. Some recent revenue drivers include: 1) the Broadridge/Accenture post-trade processing alliance, which targets European and Asian banks; and 2) an overall healthy securities trading environment. The shares have an attractive reward/risk profile based on the current valuation, business model and dividend yield/share repurchase program.

Arrow Electronics, Inc. (ARW)

(Analyst: Matt Sullivan)

Description

Arrow Electronics is a leading global distributor of semiconductors, passive and other electronic components, and midrange computing products. The company also offers a variety of value-added services including programming, system training and certification, solutions testing, and inventory and supply chain management. Arrow distributes these products and services to over 100,000 industrial and commercial customers spanning across 85 different countries.

Good Business

- As a distributor of electronics and technology systems, Arrow Electronics benefits from the global growth in high technology without being exposed to the same obsolescence risk as technology manufacturers.
- Arrow is the second largest global IT distributor and controls a large market share position in the industry. It has stood the test of time, having incorporated in 1946.
- The company has a diversified set of vendors, customers, and end markets. Arrow serves over 100,000 customers in 85 countries, including 12,000 value-added resellers. No single supplier accounts for more than 9% of overall revenues, and no single customer accounts for more than 3% of overall revenues.
- Arrow's size and product offerings create a competitive advantage that translates into better margins than most of its smaller competitors.
- Over time, the company has proven its ability to consistently earn a return-on-capital that exceeds its cost-of-capital.
- The balance sheet is modestly levered with a debt-to-total capital ratio of approximately 35%.

Valuation

- Arrow is valued at 10.3 times forward EPS estimates and 0.33 times enterprise value-to-sales.
- The mean valuation for the company over the past 10 years has been 11.8 times forward EPS estimates and .33 times enterprise value-to-sales.
- The company trades at 7.5 times EBITDA compared to a 10-year average of 8 times.

Management

- Michael Long is Chairman, President, and Chief Executive Officer. He has been CEO since 2009, and has been with the company since 1991. Prior to working at Arrow Electronics, Long worked at Schweber Electronics from 1983 until it merged with Arrow in 1991.

- Paul Reilly is Executive Vice President of Finance and Operations, and Chief Financial officer. He has held the position of CFO since 2001, and has been with the company since 1991.

Investment Thesis

Arrow Electronics is one of the world's largest distributors of electronic components and enterprise computing solutions. As a distributor of electronics, the company is in the advantageous position of benefitting from global technology growth, without being directly exposed to the short product cycles and cut-throat competition that exist for the innovators of technology. The cyclical downturn in the global components industry presented us with an opportunity to buy Arrow at an attractive price, which we believe will appreciate as some of the current trends begin to reverse.

Thank you for your confidence in Fiduciary Management, Inc.

Fiduciary Management Inc.
Small Cap Equity Composite
12/31/2002 - 06/30/2013

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 %
2003	27.18	26.22	47.25	167	1.93	n/a	n/a	$ 1,206.9	$ 2,927.0	41.23%
2004	20.92	20.02	18.33	181	1.00	n/a	n/a	$ 1,486.6	$ 3,085.8	48.18%
2005	11.12	10.26	4.55	186	0.69	n/a	n/a	$ 1,605.8	$ 3,174.4	50.59%
2006	18.46	17.56	18.37	147	0.73	n/a	n/a	$ 1,606.8	$ 3,589.4	44.77%
2007	-0.92	-1.72	-1.57	161	0.85	n/a	n/a	$ 1,520.2	$ 3,960.4	38.39%
2008	-21.06	-21.69	-33.79	145	1.16	n/a	n/a	$ 1,212.4	$ 4,062.5	29.84%
2009	35.72	34.56	27.17	165	0.97	n/a	n/a	$ 2,004.6	$ 7,008.9	28.60%
2010	23.45	22.43	26.85	170	0.48	n/a	n/a	$ 2,477.7	$ 9,816.0	25.24%
2011	5.64	4.79	-4.18	179	0.34	21.17%	24.99%	$ 2,523.2	$ 12,273.6	20.56%
2012	11.34	10.43	16.35	182	0.40	15.46%	20.20%	$ 2,609.5	$ 15,253.5	17.11%
Q1 2013	10.40	10.19	12.39	181	0.25	15.18%	19.82%	$ 2,520.2	$ 16,957.4	14.86%
Q2 2013	0.73	0.52	3.08	179	0.16	13.91%	18.34%	$ 2,504.2	$ 18,032.6	13.89%

*Benchmark: Russell 2000 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 - 06/30/2013. 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 -06/30/2013. 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 $18.0 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 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 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 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.