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INVESTMENT STRATEGY OUTLOOK – SMALL CAP EQUITY

March 31, 2015

The FMI small cap portfolios returned approximately 2.7% in the March quarter compared to the benchmark Russell 2000 Index gain of 4.32%. Sectors that helped this quarter included Commercial Services, Technology Services and Consumer Durables, while Distribution Services, Process Industries and Health Technology detracted from performance compared to the Russell 2000. Stocks that performed well in the period included Genpact, Broadridge Financial and Graham Holdings. These gains were balanced by negative results from Anixter, SQM and Lindsay. Cash was also a significant drag in the quarter. Portfolio activity was relatively subdued in the March quarter. After performing exceptionally well and reaching a full valuation, Cintas was sold. Hanger, a disappointing investment, was also eliminated.

Aside from a few bumps near 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]

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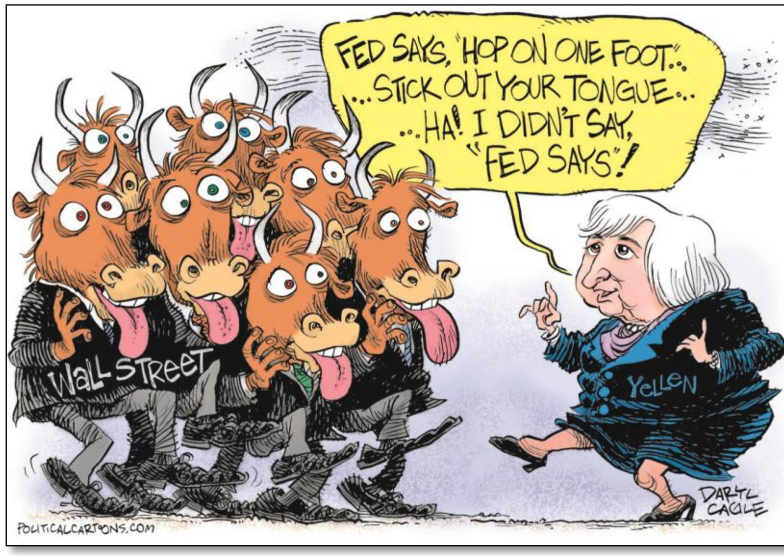
[1] Richard Dobbs, Susan Lund, Jonathan Woetzel, and Mina Mutafchieva. "Debt and (not much) deleveraging." *McKinsey Global Institute Report*, February 2015.



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.

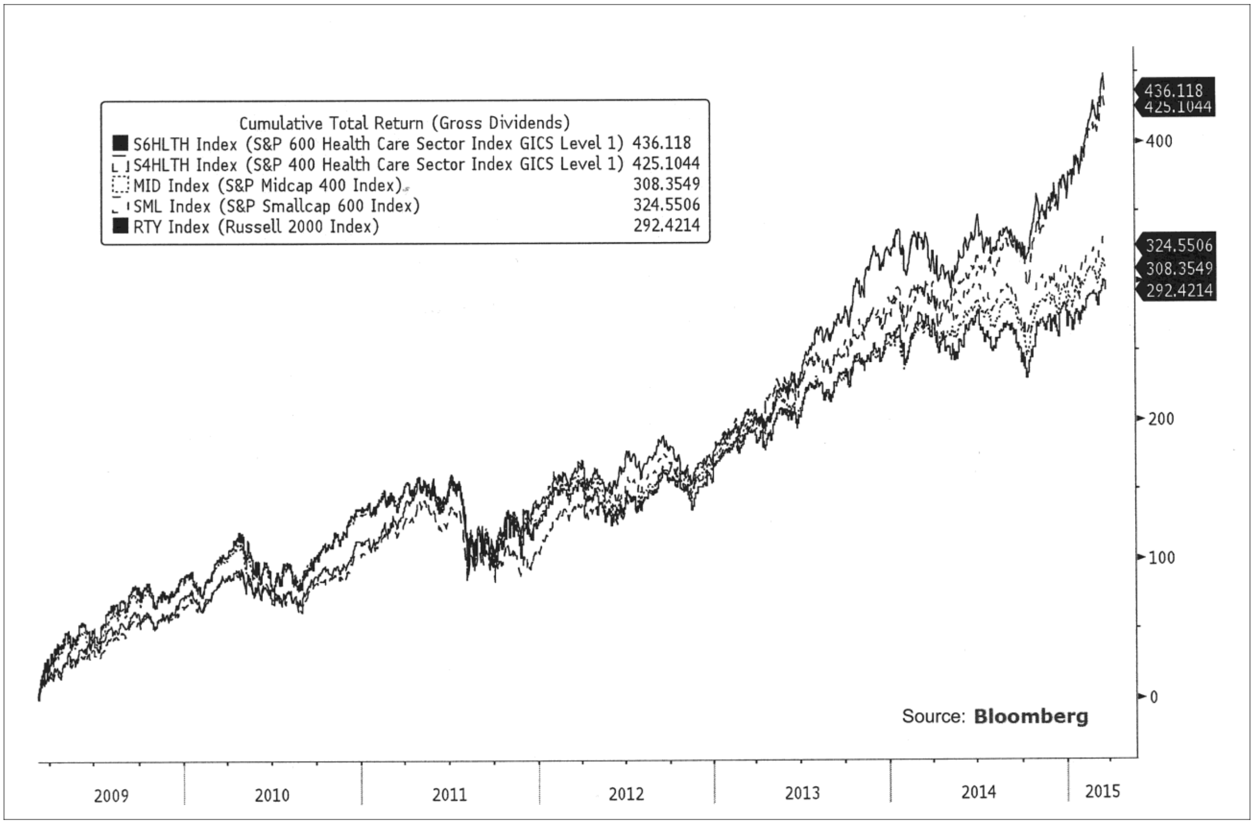
The six-year bull market, combined with tepid fundamentals, has made stocks remarkably expensive from a historical perspective. The median or "typical" stock is higher than we have ever seen, and even more expensive than during the peak of the technology and telecom craze in 1999. Today there are over 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 1.25% of the Russell 2000 constituents, accounted for approximately 75% 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.

In the small- and mid-cap area of the market, the top-heavy sectors include REITs (investors chasing yield) and health care (strong biotech and mergers & acquisitions influence). Using just healthcare to illustrate, following is a chart showing

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

performance of the small- and mid-cap S&P indices, the Russell 2000 and the small- and mid-cap S&P healthcare subsector results since the bottom of the 2009 market. The small- and mid-cap healthcare indices were up 436% and 425%, respectively, over this period, vastly outperforming the general benchmarks, which were also astounding. In the wake of this blitzkrieg, valuations are approaching levels we don't even know how to describe. Eventually, logic and a sense for history suggests this movie is likely to play in reverse, which should be a big boost to our relative performance.



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.

ManpowerGroup, Inc. (MAN)

(Analyst: Rob Helf)

Description

ManpowerGroup (Manpower) is the world's third largest provider of workforce solutions and temporary staffing services. The company places over 3 million workers in temporary, contract, and permanent positions at more than 400,000 employers annually. It is also the largest provider of career transition services (Right Management) and provides valuable employee training.

Good Business

- Manpower is one of the leading staffing companies in the world and can deliver its workforce solutions in over 80 countries.
- The company benefits from the secular trend of temporary staffing. Demand for temp staffing is growing as companies face a shortage of talent, but also require flexibility to manage costs.
- The company's margins should increase due to its greater mix of higher-value services.
- The industry is relatively fragmented, which should allow Manpower to take share from competitors that cannot compete with its scale, technology and recruiting resources.
- The company has generated a return on invested capital (ROIC) of 11% over the past decade, comfortably exceeding its cost of capital.
- If the company were to achieve margins closer to its largest international competitors, earnings per share (EPS) could be $8-9.00, or 60% higher than the current EPS run rate.
- The company's balance sheet is in excellent shape with cash in excess of debt. The business model generates a good deal of free cash, and management has been a good steward of capital.

Valuation

- Manpower trades at approximately 16.5 times forward EPS, 9.0 times earnings before interest and taxes (EBIT) and 0.30 times enterprise value-to-sales (EV/Sales).
- The company's price-to-earnings (P/E) multiple is about in line with the company's 5- and 10-year historical averages. On a 10-year basis, Manpower has traded in a range of 0.20-0.35 times EV/ Sales. With most stocks trading at least one standard deviation above their long-term historical mean, the company is a relative value.
- The company's earnings before interest, taxes and amortization (EBITA) goal equates to EPS power of $6.50-7.00, implying an 11 times multiple. If the company were to achieve margins in line with European competitors, EPS power would be over $8.00.

Management

- Jonas Prising was named Manpower's fourth CEO last May. Previously, he was President and head of the Americas and Southern Europe Region. He has been with the company since 1999 and strikes us as a very capable hands-on leader.
- Darryl Green is COO. He previously held the role of President and EVP of the Asia region.
- Mike Van Handel is CFO. He joined the company in 1989 and has been a solid financial leader for over two decades.
- Management compensation is based on economic profit, EPS and operating margin.

Investment Thesis

We initiated a position in Manpower late last fall as macro worries about the European economy and cautious company comments resulted in significant share underperformance. Europe is a significant contributor to the company's revenues and income, and this aspect will always be closely monitored. The initial position proved timely as the shares rebounded smartly. While Europe is still a mess, it's clear that on the margin, employers are favoring temporary workers over permanent employees. Longer-term, a global economic recovery and positive secular prospects for staffing, combined with a reasonable valuation, make Manpower an attractive position.

MSC Industrial Direct Co., Inc. (MSM)

(Analyst: Matt Sullivan)

Description

MSC Industrial Direct is one of the largest direct marketers and distributors of metalworking and maintenance, repair and operations (MRO) supplies to customers throughout North America. MSC operates through a network of twelve customer fulfillment centers and 103 branch offices. The company employs one of the industry's largest sales forces and distributes approximately 850,000 industrial products from approximately 3,000 suppliers to around 364,000 customers across every U.S. state, Puerto Rico, and Canada.

Good Business

- Almost every industrial, manufacturing and service business has an ongoing need for MRO supplies.
- Over the past five and ten years, MSC has earned an average ROIC of 20%, which exceeds the company's cost of capital.
- MSC earns above-average margins for a distributor by providing an integrated, low-cost solution to the purchasing, management and administration of customers' MRO needs. The company has scale advantages over smaller competitors, which allows them to provide superior services.
- The company has a diverse set of customers and suppliers. No customer or supplier accounted for more than 6% of sales in 2014.
- MSC is modestly levered with a debt-to-capital ratio of approximately 28%.
- MSC is a high free cash flow business, as it doesn't require a large amount of capital expenditures.

Valuation

- MSC's 2015 estimated P/E ratio is 18.1 times, which is approximately one standard deviation below the company's 5-year average of 20 times.
- MSC is trading at an EV/Sales ratio of 1.75 times, which compares favorably to its 5- and 10-year average EV/Sales ratios of 2.1 times and 2.0 times, respectively.
- MSC has underperformed broader market indices such as the S&P 500 and the Russell 2000 by a significant amount over the past one and two years. The company trades at a discount to the Russell 2000 despite having superior growth and return characteristics.

Management

- MSC has an impressive ROIC track record, indicating that management has allocated capital efficiently over time.
- Sid Jacobson founded the company in 1941, and his family owns just under 30% of the company. The Jacobson family controls voting power via dual class shares.
- Erik Gershwind, grandson of Sid Jacobson, assumed the CEO position starting in 2013. He has been on the board since 2010. Gershwind has been with the company since 1996. Prior to being named CEO, Gershwind was the Chief Operating Officer from 2009-2013.
- Mitchell Jacobson has been Chairman of the Board since 1998. He was also CEO from 1995-2005. At the beginning of 2013, his position was changed from Executive Chairman to non-executive Chairman.

Investment Thesis

MSC is a durable, high-quality franchise that is trading at a reasonable valuation. While growth has slowed recently across the industrial distribution industry, we believe that the longer-term sales growth opportunity for MSC remains attractive. The company also has the ability to expand its operating margin as it continues to grow sales, and leverage recent fixed capital investments. This combination should lead to above-average long-term earnings growth. With the prospect for modest multiple expansion, the stock appears to be an attractive investment opportunity.

Thank you for your support of Fiduciary Management, Inc.

Fiduciary Management Inc.
Small 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	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 %
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%
2013	33.43	32.33	38.82	180	1.04	12.51%	16.45%	$ 2,801.8	$ 19,705.3	14.22%
2014	7.99	7.06	4.89	178	0.39	9.65%	13.12%	$ 3,006.5	$ 21,001.1	14.32%

*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 - 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 Small Cap Equity composite has been examined for the periods 12/31/1993 -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 $20.0 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.