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INVESTMENT STRATEGY OUTLOOK – SMALL CAP EQUITY

March 31, 2017

The FMI Small Cap portfolios advanced approximately 3.9% in the March quarter compared to 2.47% for the Russell 2000 Index. Finance, Commercial Services and Distribution Services were among sectors that outperformed in the quarter while the Health Technology, Electronic Technology and Retail Trade sectors underperformed. W.R. Berkley, Manpower Group and MSC Industrial Direct were among the leading performers in each of the outperforming groups. W.R. Berkley continued to put up solid underwriting results, Manpower Group reported good results in most of their non-U.S. markets, and MSC Industrial Direct benefitted from a strong move in the industrial-related stocks. The below-average performance in Health Technology was due to our underweighted sector position. Esterline Technologies hurt relative performance in the period, although they reported a good quarter and the turnaround seems to be on track. Penske Automotive Group's stock also declined modestly, perhaps on currency and Brexit concerns, as they have significant dealer exposure in the United Kingdom. We remain optimistic about both Esterline Technologies and Penske Automotive Group over the next few years.

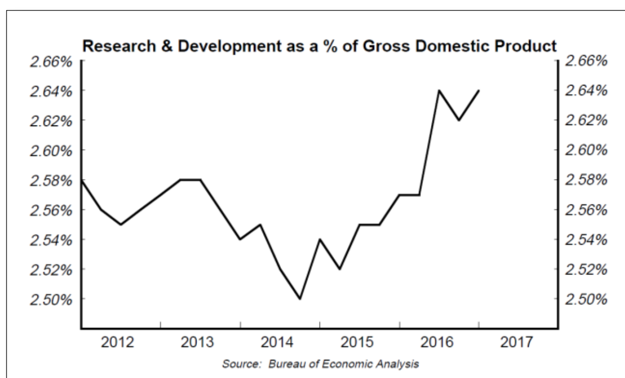
We have to admit that it has been a struggle in recent years to keep these missives fresh. There are only so many ways to say the same thing! An enduring belief in the continuation of an environment that yields low interest rates, low inflation and no accidents seems to be the law of the land, even though 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 table to the right (readings over 50 indicate expansion).

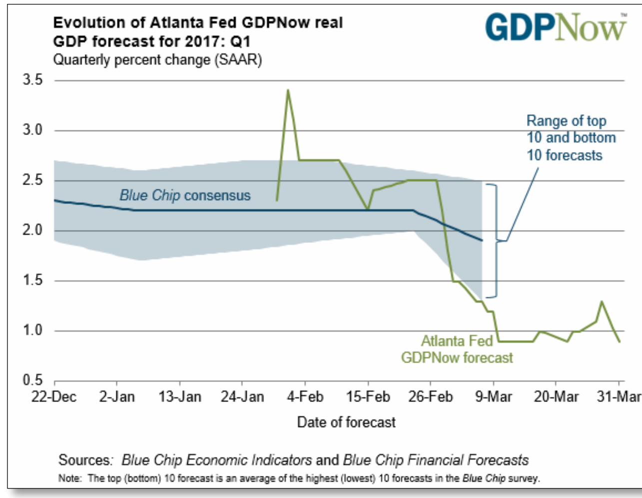
	Markit US Composite PMI (SA)	Markit Eurozone Composite PMI (SA)	Nikkei Japan Composite PMI Output (SA)	Caixin China Composite PMI Output (SA)
Mar-17	53.2	56.7		
Feb-17	54.1	56.0	52.2	52.6
Jan-17	55.8	54.4	52.3	52.2
Dec-16	54.1	54.4	52.8	53.5
Nov-16	54.9	53.9	52.0	52.9
Oct-16	54.9	53.3	51.3	52.9
Sep-16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

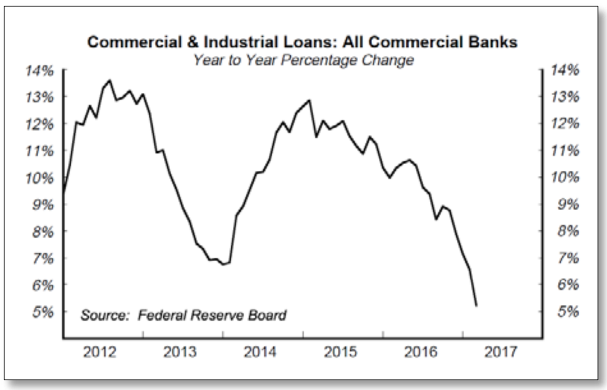


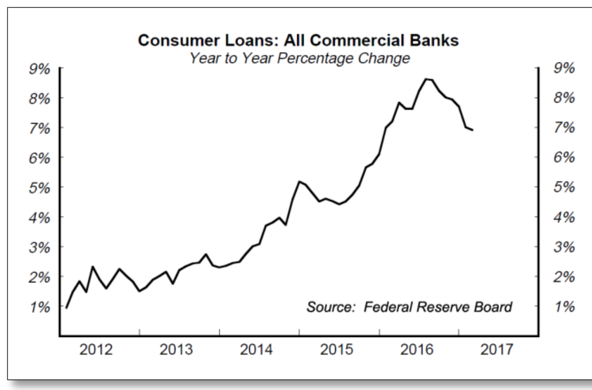
U.S. fixed business investment has recently edged higher. After being negative for the first three quarters last year, J.P. Morgan recently reported that worldwide equipment spending (excluding China) grew at a 4.1% annualized rate in the fourth quarter. Improved R&D and capital investment are two critical 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.



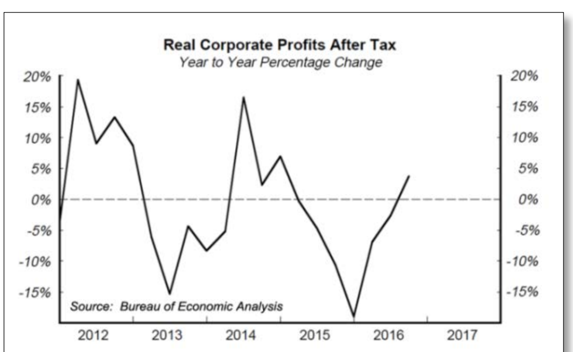
Main Street, if not Wall Street, will be thrilled if these budding positives manifest themselves into true and enduring economic growth. Counter to these positives, however, are some nagging figures. The GDPNow survey from the Atlanta Federal Reserve has been trending steadily down since late January, 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.

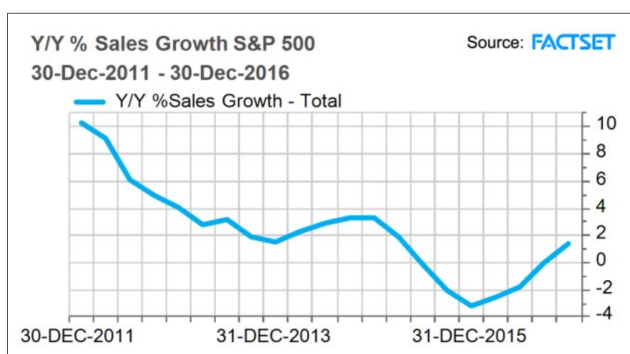
Additionally, lending activity has really begun to slow, which rarely happens when the economy is on the verge of stronger growth. David Rosenberg of Gluskin Sheff recently discussed this slowdown and we've included pictorials below of a couple of the bigger categories (Commercial and Industrial loans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

White Mountains Insurance Group (WTM)

(Analyst: Matthew Goetzinger)

Description

White Mountains Insurance Group is a financial services holding company with primary business interests in specialty lines property and casualty insurance, municipal bond insurance, and various capital light insurance services companies. The company's corporate headquarters are in Hanover, New Hampshire, while the registered offices are located in Hamilton, Bermuda.

Good Business

- White Mountains' goal is to become a premier group of property and casualty insurance and reinsurance underwriters that -- with prudent operating and financial leverage -- produces for its owners a long-term return equal to 700 basis points over the 10-Year Treasury yield.
- The company's insurance businesses sell a broad range of high value-added insurance protections against a variety of risks.
- White Mountains functions as an intelligent allocator of capital and allows each member of the group to focus on prudent underwriting and a long-term focus.
- Over long periods of time that include the 2009 financial crisis, the bear market of the early 2000's for the S&P 500 Index, and a number of signficant acquistions and subsequent divestitures, the company's long-term adjusted book value per share has grown at a 14% cumulative annual growth rate, outpacing the market (excluding dividends) by approximately 350 basis points.
- The company's operating businesses are well-capitalized.

Valuation

- White Mountains trades at a slight premium to stated book value per share, and approximately in line with a mark-to-market appraisal of the company's net asset value.
- White Mountains' share price has closely tracked growth in the company's book value per share over time.

- Recent takeovers of primary and specialty lines property and casualty insurance companies have been at approximately two times book value.

Management

- White Mountains' holding company is managed by a group of key decision makers that have been with the company for over ten years.
- Management clearly understands economic returns on capital.
- Absent an opportunity to acquire attractively valued new operating businesses, the company has used their capital to repurchase stock at a discount to book value per share.

Investment Thesis

White Mountains' long-term partnership model provides a means to gain exposure to a diversified portfolio of differentiated insurance business managed with a focus on long-term value creation. The company's significant balance of holding company cash preserves optionality and should function as a portfolio ballast in a more challenging stock market environment.

Allscripts Healthcare Solutions, Inc. (MDRX)

(Analyst: Matt Sullivan)

Description

Allscripts is a leading supplier of information technology (IT) solutions and services to a wide range of healthcare providers, including physicians, hospitals, health plans, clinics, pharmacies, pharmacy benefit managers and post-acute care organizations. Allscripts has one of the largest client bases in the healthcare IT industry, as their products and services are used by over 180,000 physicians, 2,500 hospitals and 45,000 post-acute care facilities. The company was founded in 1986 and is headquartered in Chicago, Illinois.

Good Business

- The business has a significant amount of recurring revenue; approximately 80% of the company's revenue is now recurring in nature.
- Allscripts' software and services are mission-critical for customers and have high switching costs.
- The company has a large, diverse customer base.
- Allscripts' software products can integrate and exchange data with most other healthcare IT providers; this is becoming increasingly important in the industry.
- A large portion of Allscripts' future growth will come from selling existing customers additional software and services. We believe this is an attractive growth opportunity as Allscripts is already highly entrenched within these customers' operations.
- The business generates solid free cash flow and high returns on invested capital. We estimate that Allscripts' true return on invested capital is over 20%.

Valuation

- Allscripts' performance is down around 11% from its 52-week high. It has underperformed the Russell 2000 by 30%, 7% and 52% over the past one, two and three years, respectively, on a total return basis.
- Allscripts owns a 10% stake in NantHealth, a precision health IT company worth $57 million. Allscripts also owns 49% of a joint venture called NetSmart that we estimate is currently worth around $330 million to Allscripts. After taking these investments into account, we believe that Allscripts' core business is trading at about 1.8 times sales, which is one standard deviation below the company's five-year average, and well below where other comparable companies trade.
- After considering the NantHealth and NetSmart investments, we believe that Allscripts' core business has a 6 % free cash flow yield. We believe this is an attractive yield, given the company's highly recurring revenue and solid growth prospects.
- Take-out multiples for direct peers and a broader set of software companies indicate that Allscripts trades at an attractive valuation. We believe this provides us with some downside protection.

Management

- Paul Black has served as Chief Executive Officer and has been on the board of directors since 2012. Prior to joining the company, he was an Operating Executive of Genstar Capital, a private equity firm, and Senior Advisor at New Mountain Finance Corporation, an investment management company. From 1994 to 2007 Mr. Black served in various executive positions at Cerner Corp., including Chief Operating Officer from 2005 to 2007.
- Mr. Black has brought a number of former Cerner executives to the company to run different divisions of Allscripts.

Investment Thesis

Allscripts is a good business with a high level of recurring revenue, high switching costs, a diverse customer base, and attractive returns on invested capital; however, the business has gone through a significant amount of change over the past few years from both an operational and financial perspective, which has caused the stock to lag. This has been compounded by the election of Donald Trump, which created uncertainty about the future of the Affordable Care Act and put additional pressure on healthcare stocks.

It is our belief that changes to the business are now largely completed, and that top line growth is set to accelerate over the next few years. Furthermore, while we don’t know what will replace the Affordable Care Act, we are confident that IT will have an increasingly important role in delivering healthcare going forward. Therefore, we’re willing to look past the near-term macro uncertainty and own this above average business at a below-average valuation.

Thank you for your confidence in Fiduciary Management, Inc.

Fiduciary Management Inc.
Small 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	-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%
2015	-5.72	-6.52	-4.41	171	0.34	11.18%	13.98%	$ 2,597.2	$ 21,042.9	12.34%
2016	21.65	20.65	21.31	171	0.46	12.02%	15.77%	$ 2,596.0	$ 22,626.7	11.47%

*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 - 12/31/2016. 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 Small Cap Equity composite has been examined for the periods 12/31/1993 -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 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.