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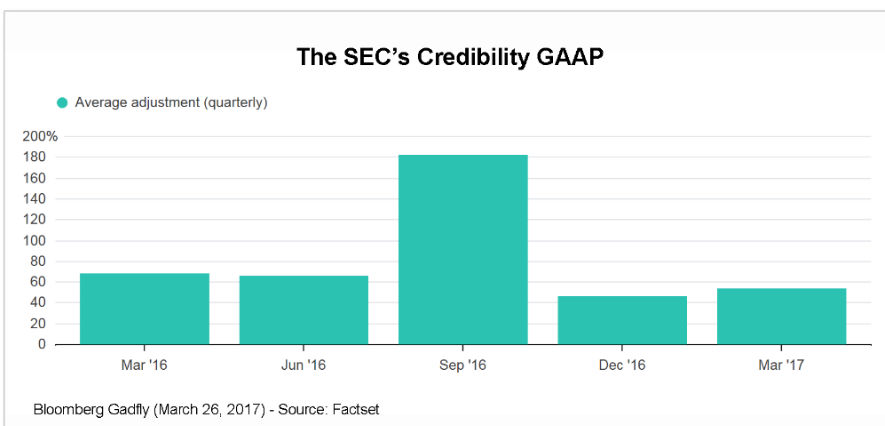
INVESTMENT STRATEGY OUTLOOK – SMALL CAP EQUITY

June 30, 2017

The FMI Small Cap portfolios gained approximately 2.5% in the June quarter compared to 2.46% for the Russell 2000 Index. Energy, Finance and Consumer Services were all positive contributors, from a sector standpoint. Our low direct exposure to Energy accounted for the outperformance of this sector, as energy prices fell dramatically. FirstCash and Cable One were the leading performers in Finance and Consumer Services, respectively. On the flipside, Health Technology, Health Services, Technology Services and elevated cash all detracted from performance. Our low exposure to Biotechnology and other Health Technology businesses (due to valuation) hurt, while MEDNAX and Allscripts also underperformed. Our underweighted position in Technology Services was also a factor on the downside.

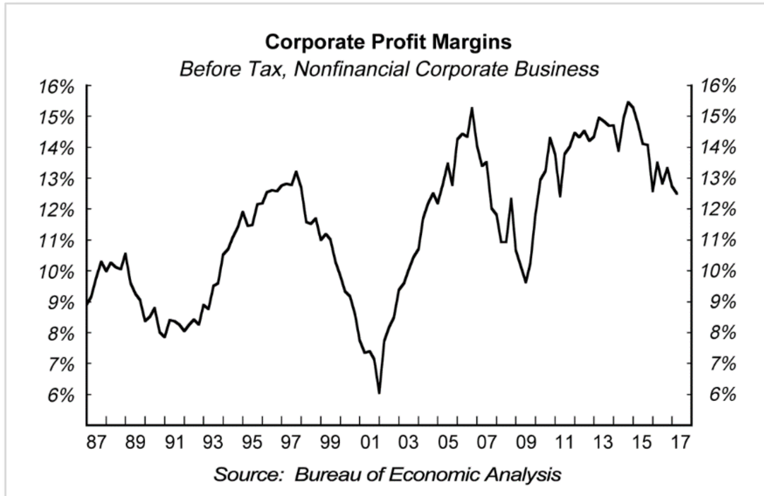
Final data is not yet available for the June quarter, but March quarter corporate sales growth improved to roughly 5-7% (depending on firm size) from flat to down in 2016. Estimates for second quarter revenue growth appear to be in the 4.5% range, according to FactSet. This is an encouraging improvement over the flattish revenue growth corporations experienced in 2016. Last year corporate sales growth lagged nominal GDP growth (+2.95%); thus far in 2017 it looks to be the opposite. Nominal GDP growth estimates for 2017 have been reduced in recent months due to some developing weaknesses that are articulated below. Over time, nominal GDP growth and U.S. corporate sales should be highly correlated.

It has been widely reported in the financial and popular press that earnings grew approximately "14%" in the first quarter. One should always be wary when the subject is earnings. In recent years, it has been common to read about double-digit earnings growth, but unless margins have expanded significantly, earnings growth should be about the same as sales growth. Margins are actually down modestly from their peak, so that hasn't driven the earnings improvement. The earnings results reported by Bloomberg, CNBC and brokers are what we affectionately call B.S. or "Wall Street" earnings. These earnings have been "adjusted" to exclude the all-too-familiar "one-time" items, a.k.a. unpleasant things, amortization of intangible assets, and in some cases, other elements like stock compensation. It turns out that over 400 of the S&P 500 companies now use "adjusted" earnings. The widely-respected economist David Rosenberg had this to say about first quarter 2017 earnings: "But the unscrubbed data for all companies, big and small, listed and unlisted, in strict dollar terms and importantly, seasonally adjusted, actually shrank 7.3% in the first quarter (at an annualized rate) and the year-to-year trend decelerated to 3.7% from 9.3%." Bloomberg recently cited Factset numbers showing how wide the gap between Wall Street earnings and GAAP (generally accepted accounting principles) earnings has become (see chart above).



Because of the wide use of adjusted figures, it is difficult to determine at what rate earnings are actually growing, but over time, it is logical to assume that the rate should roughly match revenue growth. With higher corporate revenue growth being reported, we hope true earnings also move into the mid-single-digit growth rate range.

Margins, as mentioned, have come down from their peak but remain quite high from a historical perspective. The significant improvement in margins over the past eight years is largely due to lower interest expense and the effects of higher leverage being deployed on corporate balance sheets, rather than an organic improvement in efficiency. Interest rates and leverage may have run their respective courses as the Fed tightens, and corporations' ability to add more debt to already stretched balance sheets is limited. Share repurchase activity has moderated, diminishing this source of earnings per share (EPS) growth.



Today we have the proverbial mixed bag of corporate and economic signals. Institute for Supply Management (ISM) numbers continue to be above 50, and core investment in research & development have bounced off the bottom. Corporate revenue growth picked up in the first quarter (and may be decent in the second quarter) but at the same time, some important economic indicators are going the other way. These factors get little airtime in a bull market but they are worth noting. Housing starts dropped 5.5% in May to 1.092 million units at an annual rate, the weakest since September. As David Rosenberg reports, "This was the third straight decline—a whopping plunge of 48% annualized over this stretch…" Multi-family housing starts dropped 9.7% -- the fifth monthly drop in a row. The long up cycle in autos appears to have rolled over, with new car sales falling in four of the last five months. Oil prices have collapsed. Durable goods orders slipped 0.2% in May. The 10 Year Treasury yield has rolled over. Lending volumes across a variety of consumer and business categories have fallen, as articulated in last quarter's letter. Wage growth and consumer spending remain subdued even though the unemployment rate is low at 4.3%. The Economic Cycle Research Institute (ECRI) index of weekly leading indicators growth rate has fallen significantly in 2017, from approximately 11% to 4%.

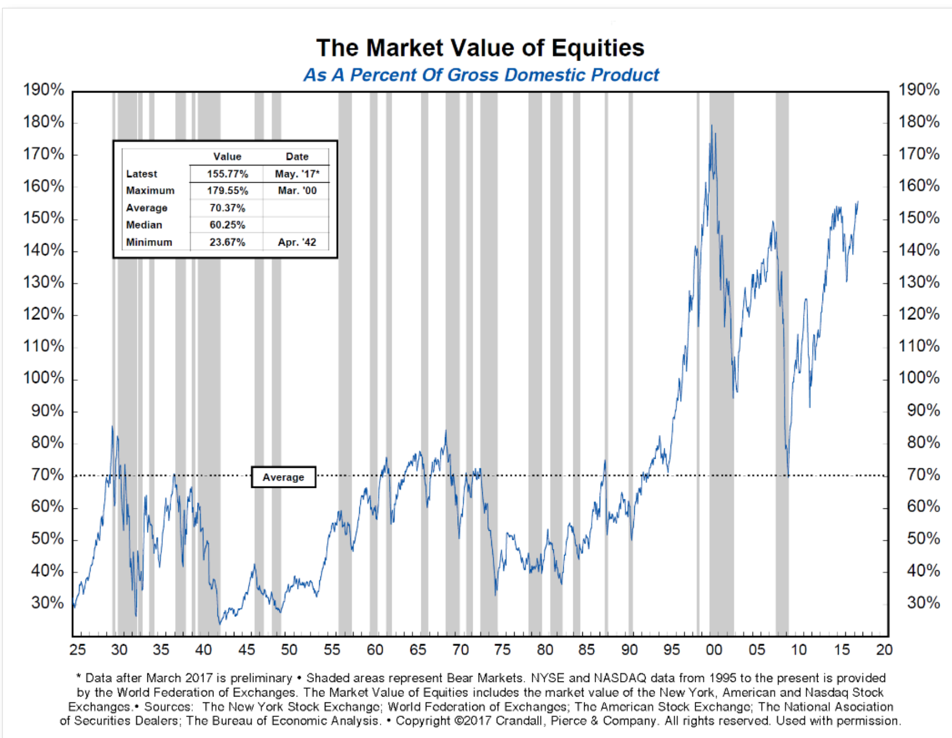
Stock prices, on the other hand, continue to soar. The character of the market has also returned to momentum and speculation. Biotechnology investing has become a casino again. [Investors seem to have forgotten the prior collapses in this sector.] The so-called FAANG stocks (Facebook, Amazon, Apple, Netflix and Google [Alphabet]) have been on fire and the market has become narrower, as is customary late in the cycle. Additionally, the growth style has beaten the value style over both short-and long-term time horizons, seemingly calling into question the widely-held notion that value always trumps growth over the long run, as depicted in the table to the right.

Cumulative Total Returns Through 06/30/17

	1 yr.	3 yr.	5 yr.	10 yr.
Russell 1000 Value Index	15.5%	23.7%	92.0%	71.6%
Russell 1000 Growth Index	20.4%	37.2%	103.8%	134.8%
Value performance	*-4.9%*	*-13.5%*	*-11.8%*	*-63.2%*
Russell 2000 Value Index	24.8%	22.5%	87.3%	77.4%
Russell 2000 Growth Index	24.4%	24.7%	92.4%	112.0%
Value performance	*0.4%*	*-2.2%*	*-5.1%*	*-34.6%*
MSCI EAFE Value Index	25.8%	0.4%	53.1%	6.6%
MSCI EAFE Growth Index	16.2%	10.1%	58.4%	27.8%
Value performance	*9.6%*	*-9.7%*	*-5.3%*	*-21.2%*
MSCI Emerging Markets Value Index	21.6%	-3.9%	8.6%	16.4%
MSCI Emerging Market Growth Index	26.0%	10.6%	35.0%	24.6%
Value performance	*-4.4%*	*-14.5%*	*-26.4%*	*-8.2%*

Source: Bloomberg

The remarkable duration of this bull market has turned the world upside down for most of us on the value spectrum. We are confident that once we see the flipside of today's up cycle, value outperformance will be restored. Our industry is trained to look at 3- and 5-year performance. What happens when the cycle goes one way (up) for eight, nine or ten years? Two things happen: First, valuations go to extremes; today the data shows we are near all-time highs in most valuation measures. The roughly fifty valuation measures that Leuthold Group tracks, which we cite in nearly every letter, reside in the ninth decile and are pushing the tenth. Warren Buffett's favorite stock market measure of value (total stock market value divided by GDP) is also near a record high (see chart to the right). Second, passive strategies gain share and become momentum strategies. These two elements could get even more extreme if the passive to active flow turns into a torrent.

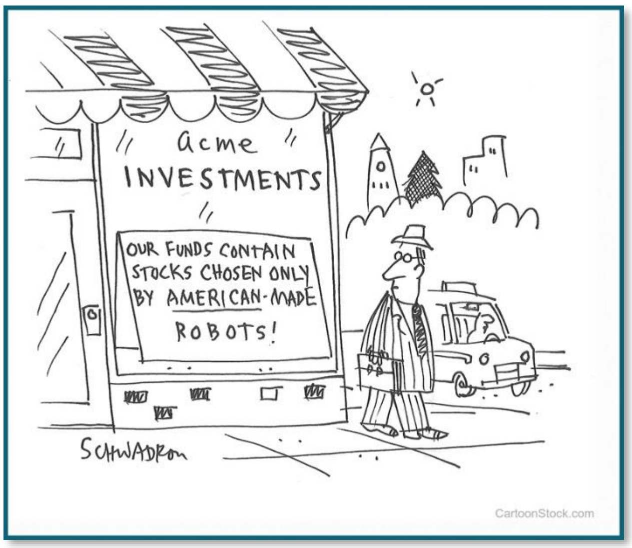


* Data after March 2017 is preliminary • Shaded areas represent Bear Markets. NYSE and NASDAQ data from 1995 to the present is provided by the World Federation of Exchanges. The Market Value of Equities includes the market value of the New York, American and Nasdaq Stock Exchanges.• Sources: The New York Stock Exchange; World Federation of Exchanges; The American Stock Exchange; The National Association of Securities Dealers; The Bureau of Economic Analysis. • Copyright ©2017 Crandall, Pierce & Company. All rights reserved. Used with permission.

The popularity of index funds and exchange-traded funds (ETFs) has a structural aspect and a chase-the-winner (momentum) aspect. Investors' desire to have low-cost funds, along with the belief that passive will continuously beat active, have caused a structural movement in this direction. We acknowledge that passive will have a larger share of the market over time. In the investment business, however, it's always important to remember the old quote, "What the wise do in the beginning, fools do in the end." We have little doubt that the capitulation taking place today will be wrong. Steve Bregman, from Horizon Kinetics, last fall published data showing some interesting characteristics of the ETF and index world that reveal just how risky the passive approach has become. The correlation of the largest members of the S&P 500 with the index has about doubled over the past twenty years. Additionally, many of the largest ETFs have seen their correlations with the S&P 500 reach very high levels, as depicted in the table above (with perfect correlation as 1.0). Even investors who acknowledge that the S&P 500 has become a crowded trade, and who move into ETFs to diversify, may find their results moving right with the S&P 500 after all.

Correlation with S&P 500* (12/31/07-06/30/16)		
IYW	iShares US Technology	0.903
BJK	Market Vectors Gaming	0.807
IYH	iShares US Health Care	0.815
IYE	iShares US Energy	0.755
ITB	iShares US Home Construction	0.681
IYT	iShares Transportation Avg	0.858
EWW	**iShares Mexico Capped ETF**	**0.826**
EWJ	**iShares MSCI Japan ETF**	**0.739**

Source: Bloomberg, monthly returns, Horizon Kinetics Research
* Selected non-fin'l S&P constituents that have existed for 20 years using Bloomberg correlation matrix (12 months daily return).



Additionally, due to the rapid adoption of ETF trading, the turnover rates of the largest ETFs have skyrocketed. The two most popular, The SPDR S&P 500 ETF and the iShares Russell 2000 Index ETF, have turnover rates that exceed 3500% (an average holding period of about a week). As Bregman points out, "That is dozens of times greater than the trading liquidity of even its most liquid constituents. [...] When the music stops, is there enough underlying liquidity?" With robots (algorithms) in charge, we could see some very unusual ETF behavior when volatility arrives.

It is fascinating to look at the last peak in the market, which was October 9, 2007. The Leuthold Group thought it would be interesting to investigate how investors would have done had they been "unlucky" enough to enter the market at the absolute peak. They then decomposed the returns into the following table.

Contributions To S&P 500 Total Return: October 2007 Bull Market Peak Through April 28, 2017

	October 9, 2007	April 28, 2017	Percent Chg.	9 1/2 Yrs. Annualized
S&P 500 Sales Per Share	$986.11	$1,150.68	16.7 %	1.6 %
S&P 500 Net Profit Margin	8.6 %	8.2 %	-4.8 %	-0.5 %
S&P 500 12-Mo. Trailing GAAP EPS	$84.92	$94.55	11.3 %	1.1 %
S&P 500	1565.7	2384.20	52.3 %	4.5 %
P/E on 12-Mo. Trailing GAAP EPS	18.4 x	25.2 x	36.8 %	3.4 %
S&P 500 Dividends Per Share	$28.24	$47.92	69.7 %	5.7 %
Dividend Contribution To Return				2.3 %
S&P 500 Total Return Index	2447	4584.82	**87.4 %**	**6.8 %**

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Putting aside the incredibly low growth rate in sales and earnings per share (1.6% and 1.1%, respectively) -- which may be the subject of another letter -- it turns out investors did surprisingly well… 6.8% compounded over 9 ½ years. Note, however, from where these returns have come. Roughly half of the return was “fundamental” (+1.1% earnings growth and +2.3% from the dividend), and half was from multiple expansion. When looking at future returns, it seems highly unlikely that multiples (which are at extremes), or margins (which are high from a historical perspective), will provide a tailwind. The opposite is much more likely, leaving the burden for performance on fundamental sales and earnings growth. Unless we break into a period of rapid sales growth, the backdrop for fundamentally-driven equity performance in the near term seems limited.

Today is a very trying and testing time for the cautious, the skeptic, the value-oriented and the history lover. Short sellers and hedge funds that are truly hedged have been closing down. Investment committees and the public are increasingly chasing a very crowded trade (passive management). A visible long-time stock market skeptic has recently capitulated. It’s a sobering reminder that the market sometimes operates on a time horizon that is much longer than investors’ patience. While we remain strong believers in equities for the long run, we are trying to be as cautious and prudent as possible in the short run.

Thank you for your confidence in Fiduciary Management, Inc.

Fiduciary Management Inc.
Small Cap Equity Composite
12/31/2006 - 03/31/2017

Year	Total Return Gross of Fees %	Total Return Net of Fees %	*Benchmark Return %	Number of Portfolios	Dispersion %	Three Year Ex-Post Standard Deviation Composite	*Benchmark	Total Composite Assets End of Period ($ millions)	Total Firm Assets End of Period ($ millions)	Percentage of Firm Assets %
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%
Q1 2017	3.85	3.64	2.47	176	0.15	11.60%	15.46%	$ 2,633.1	$ 24,541.9	10.73%

*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 - 03/31/2017. 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 -03/31/2017. 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 $24.5 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.