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INVESTMENT STRATEGY OUTLOOK – SMALL CAP EQUITY

December 31, 2019

The FMI Small Cap Portfolios returned approximately 5.0% in the quarter compared to 9.94% for the Russell 2000 Index. For the calendar 2019 year, the gain was approximately 27.1%, and the Russell 2000 advanced 25.52%. Either all or most of this quarter's and 2019's benchmark performance was driven by multiple expansion, as earnings growth was negative through the first three quarters of 2019 (Q4 hasn't yet been reported). The short explanation of this market is that most stocks gained, but generally high-multiple growth stocks gained the most. In the large cap arena, for example, Apple gained over $500 billion in market value during the year, to $1.3 trillion. The *gain* in this stock alone was more than the market capitalization of all but five companies (Apple being one) in the Standard & Poor's 500 Index, even though Apple had negative revenue and earnings growth in the reported trailing twelve months results. During the calendar quarter, sectors that contributed positively to performance included Utilities (underweight), Process Industries and Commercial Services. Finance, Producer Manufacturing and Health Technology detracted from performance, as did cash. ManpowerGroup, Avery Dennison and Zions Bancorp were standout performers, while FirstCash, W. R. Berkley and Armstrong World Industries detracted. For the year, the Small Cap portfolios performed at, or ahead, of what we would have expected in a runaway bull market. Our clients typically invest in FMI strategies for full cycle results; we almost always underperform robust markets and outperform weak ones. Litman Gregory, a noted industry adviser and consultant, recently depicted these results graphically, based upon the nearly 18-year track record of our domestic FMI Large Cap Fund (FMIHX)[1], which shares the same investment principles as the FMI Small Cap equity strategy (Figure 1).

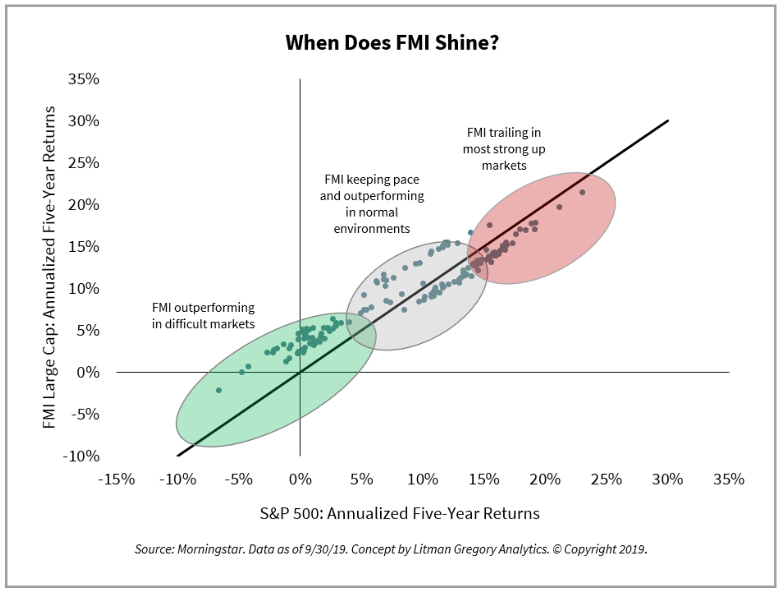

Figure 1

1

Performance	Q4 2019	One Year	Three Years	Five Years	Ten Years	Since Inception
FMIHX	**5.80%**	**23.66%**	**12.31%**	**9.48%**	**11.59%**	**9.29%**
S&P 500 Index	9.07%	31.49%	15.27%	11.70%	13.56%	8.08%

Inception: December 31, 2001

Note: Returns for periods less than one year are not annualized. Returns may not match those reported by other sources such as Morningstar due to slight valuation differences at the end of the reporting period.

<u>Performance data quoted represents past performance; past performance does not guarantee future results.</u> Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of a Fund may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by visiting <u>www.fmifunds.com</u> or by calling 1-800-811-5311. The returns do not reflect the deduction of taxes that a shareholder would pay on Fund distributions or the redemption of Fund shares.

As of the Fund's Prospectus dated January 31, 2019, and supplemented August 12, 2019 and September 9, 2019, the FMI Large Cap Fund Investor Class annual operating expense ratio is 0.80%.

The Economy

The U.S. economy has been slowing for most of the year. Industrial production figures have generally been weak since the start of the year, as depicted in Figure 2. U.S. PMI figures, which we highlighted in last quarter's letter, softened further until November, when the data lifted. An improved employment report in November also buoyed spirits. Notwithstanding these positive signs, other key indicators continue to suggest weakening momentum in the economy. New orders for durable goods and capital investment intentions have softened, automobile manufacturing remains weak, U.S. railway traffic is down over 8% and most non-U.S. economies have slowed further, with the Organisation for Economic Co-operation and Development (OECD) real GDP growth estimate for 2020 recently slipping to 2.9%.

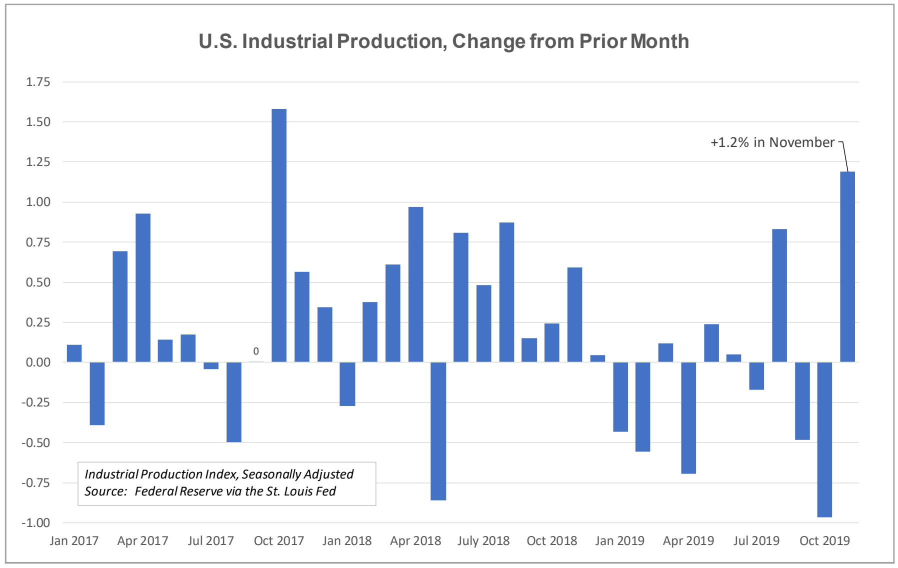

Figure 2

Bloomberg estimates that 2019 U.S. real GDP growth was approximately 1.8%. Over the prior five years (2014-2018), real GDP growth averaged 2.5%. While these figures represent economic expansion, they are quite weak from a historical perspective. The prior ten expansions averaged 4.3% growth. Apparently, the economy has been soft enough to warrant the continuation of an eleven-year experiment in financial engineering at The Fed, and essentially nonstop stimulus by fiscal authorities. The latest Fed action ("Don't call it QE!") involves roughly $500 billion of money-printing to "calm" money markets, which buckled due to "liquidity pressure." This money seems to have been recycled right into equities. Congress and the President aren't to be left out of the party, as deficit spending has once again surpassed $1 trillion and the overall debt and debt-to-GDP ratio (approximately 100%) are now at levels unheard of outside of wartime (Figure 3). Nobody is minding the store. Additionally, according to the Federal Reserve, U.S. business debt now exceeds U.S. household debt for the first time since 1991.

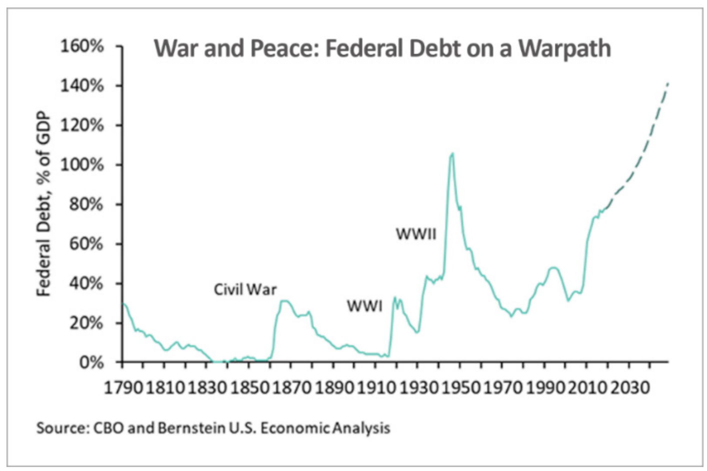

Figure 3

Congress, the President, executive and legislative economic advisors, bond managers, equity chiefs, and private equity sponsors almost uniformly tell us not to worry about the debt load because, after all, inflation is under control. We continue to question this. Anecdotally, when we ask around the office about prices for products and services our employees are actually (rather than theoretically) consuming, nearly all believe inflation is higher than the latest Consumer Price Index (CPI)

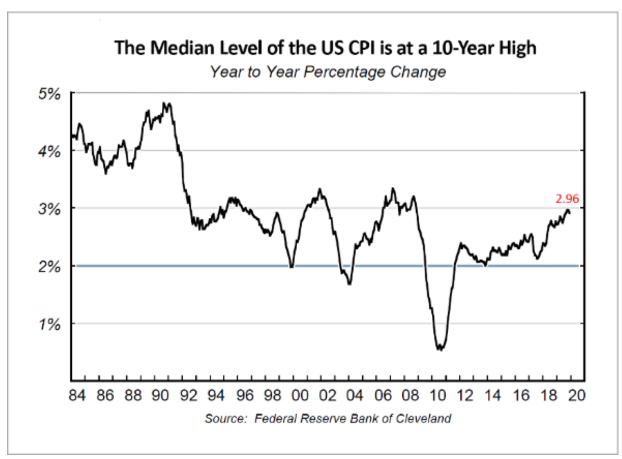

Figure 4

figure of 2.1%. And even that official figure is up from essentially 0% in 2015. The median CPI has gained steadily over the past four years to a recent 2.96%. Additionally, using the same CPI calculation methodology employed in 1990 (before the concept of hedonic price adjustments was introduced) inflation would be around 5% (Figure 4 and Figure 5). Diminishing purchasing power is the oldest trick in the book to deceive populations into continuing to support profligate fiscal and monetary policies.

Earlier we mentioned the phenomenal gain in Apple's stock despite weak fundamentals; that is not an aberration. There are hundreds of stocks that have had huge moves despite less-than-scintillating underlying fundamentals. We recognize the market is forward-looking but many stocks have been gaining for years far in excess of underlying earnings growth or other measures of value. What we are seeing appears to be raw speculation. If one looks at corporate pretax profits as measured by the Bureau of Economic Analysis (BEA), they are actually *down* 13% from five years ago (Figure 6). S&P 500 reported earnings have grown by 31% during this time frame but as *The Wall Street Journal* pointed out recently, much of this was driven by lower taxes and large S&P 500 multinationals' ability to lower their tax rate more than the thousands of corporations that make up the BEA series. From here, however, we don't see corporate tax rates continuing to fall. An additional factor cited in that article is aggressive accounting, which we have mentioned in previous letters. On a pretax basis, S&P 500 earnings have only grown modestly over the past five years, yet the index has compounded at 11.70% since the end of 2014.

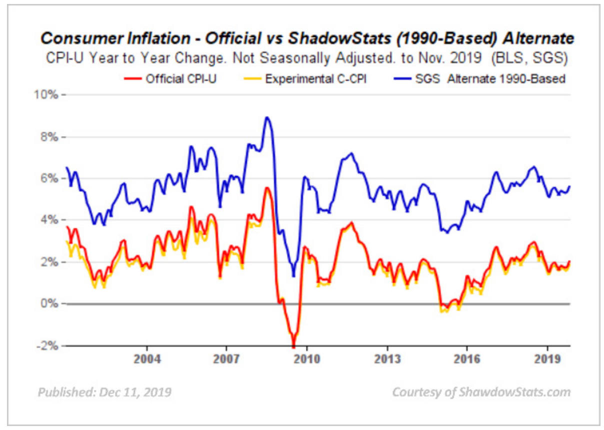

Figure 5

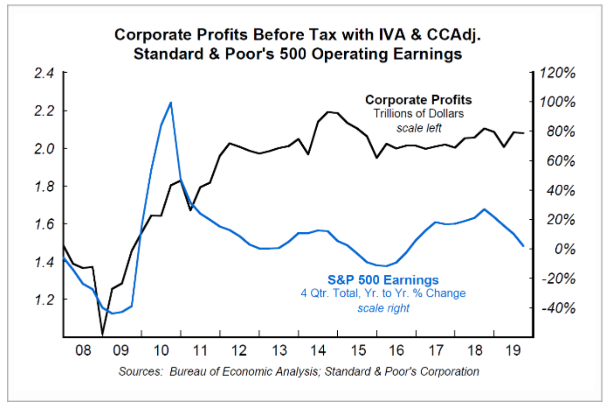

Figure 6

Stock markets that depend on multiple expansion to deliver performance can be dangerous. As is typical in this kind of environment, expanding multiples have disproportionately benefitted growth stocks relative to value stocks, as illustrated in the accompanying oft-used table (Figure 7). We don't believe this will last forever!

A Tough Stretch for Value

Annualized Total Returns Through 12/31/2019

	1 yr.	3 yr.	5 yr.	10 yr.
MSCI World Value Index	22.8%	9.2%	7.2%	8.7%
MSCI World Growth Index	34.2%	17.3%	11.5%	11.5%
Value performance	*-11.4%*	*-8.1%*	*-4.3%*	*-2.8%*
Russell 1000 Value Index	26.5%	9.7%	8.3%	11.8%
Russell 1000 Growth Index	36.4%	20.5%	14.6%	15.2%
Value performance	*-9.9%*	*-10.8%*	*-6.3%*	*-3.4%*
Russell 2000 Value Index	22.4%	4.8%	7.0%	10.6%
Russell 2000 Growth Index	28.5%	12.5%	9.3%	13.0%
Value performance	*-6.1%*	*-7.7%*	*-2.3%*	*-2.4%*
MSCI EAFE Value Index	16.1%	6.3%	3.5%	4.0%
MSCI EAFE Growth Index	27.9%	12.8%	7.7%	6.9%
Value performance	*-11.8%*	*-6.5%*	*-4.2%*	*-2.9%*
MSCI Europe Value Index	19.6%	4.6%	4.3%	5.7%
MSCI Europe Growth Index	32.4%	10.4%	8.8%	9.7%
Value performance	*-12.8%*	*-5.8%*	*-4.5%*	*-4.0%*
MSCI Emerging Markets Value Index	11.9%	8.6%	3.7%	2.1%
MSCI Emerging Market Growth Index	25.1%	14.5%	7.4%	5.2%
Value performance	*-13.2%*	*-5.9%*	*-3.7%*	*-3.1%*

Source: Bloomberg

Figure 7

With the market caps of the largest companies now reaching extraordinary heights, we are reminded of two previous similar environments. The last half of the 1980s saw Japanese stocks go into orbit. In 1987, Nippon Telephone and Telegraph, with the largest market cap in Japan (but just a plain old phone company), had a market value greater than the ten largest U.S. companies combined. In early 2000, the ten highest valued S&P 500 constituents represented 35% of the U.S. GDP. Both of these extreme market conditions dramatically corrected. Today, the largest ten S&P 500 market capitalization stocks represent 33% of current U.S. GDP, so, about as top-heavy as the great tech bubble. Additionally, Apple, Microsoft, Alphabet and Amazon combined total $4.3 trillion as of December 31. Excluding the U.S., they are larger than any stock market index in the OECD, including the Nikkei 225, Germany Dax, France CAC and Euro Stoxx.

Valuations, as you might surmise, are near all-time highs. We often recall the old axiom that "markets make opinions." After such a long period of high multiples, rationalization theories proliferate. One recent theory suggests that over the past thirty years, in addition to businesses perhaps being more stable than previously and indices having more so-called growth companies, it's largely low inflation expectations that justify a new range for multiples. So, *voila!* -- the goal posts are moved (Figure 8). The analysis neglects to discuss relative earnings growth rates in the earlier periods versus recent decades.

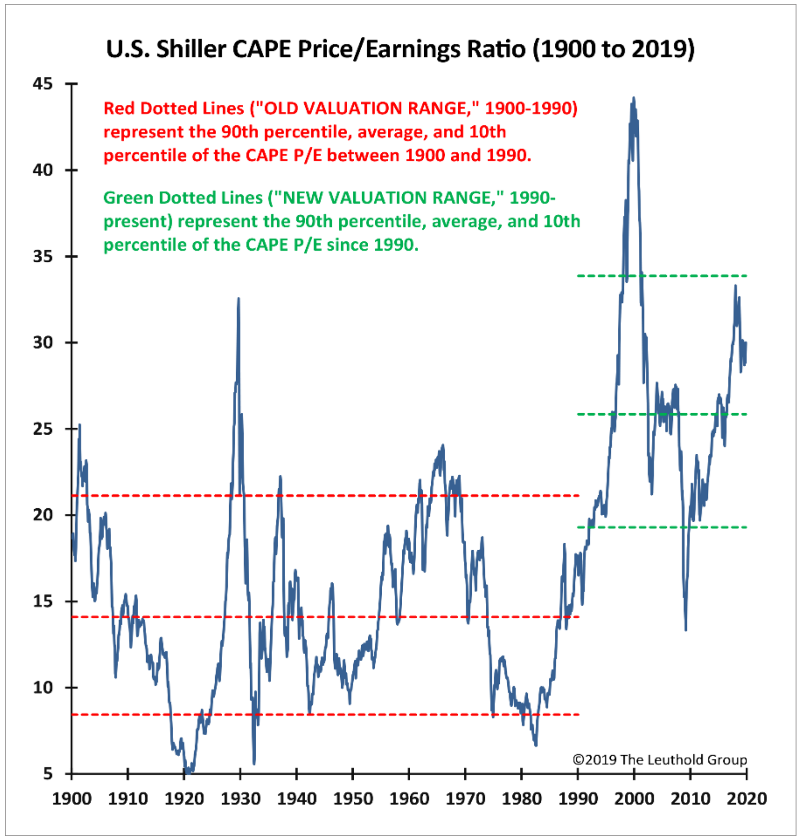

Figure 8

As mentioned, earnings growth has been weak and balance sheets are more levered than they have been historically. Moreover, the higher valuation period, as depicted in the nearby graph, has benefited from a once-in-three lifetimes move from high rates to low rates. If there is any regression to the mean, stock markets face a headwind, not a tailwind. We clipped a few headlines (Figure 9) that epitomize the notion, "It's different this time."

Is value investing dead? It might be and here's what killed it.
- CNBC (June 23, 2019)

Reversion to the Mean Is Dead. Investors Beware.
- Barron's (May 3, 2019)

Fed, central banks have almost eliminated recessions…
- CNBC (April 30, 2019)

What If the Bull Market Just Never Ends?
- Bloomberg (April 24, 2019)

"I don't think rates will rise in the foreseeable future, maybe never again in my lifetime."
- National Economic Council Director Larry Kudlow (April 11, 2019)

Figure 9

We aren't buying it. Fundamentals should drive stock performance over time; everything else is speculation. People are fixated on what they are being fed every day by the pundits: interest rates and inflation will never be a problem, you have to own the most popular growth stocks, and we are in a new valuation era. There are no new eras in finance and investing. Excesses always evaporate. The unexpected happens. We'll reiterate the findings we cited in our September 2017 letters, which discussed that investors knowingly bought risky securities and tended to "choose portfolios that look a lot like others in their community or professional cohorts." Our portfolios and our team do not follow the herd. We are working diligently to prepare for the inevitable change that comes to all markets in time.

Thank you for your confidence in Fiduciary Management, Inc.

FMIHX - Top 10 Portfolio Holdings:	
Berkshire Hathaway Inc. Cl B	6.3%
UnitedHealth Group Inc.	5.6%
Masco Corp.	5.0%
Dollar General Corp.	5.0%
JPMorgan Chase & Co.	4.9%
Honeywell International Inc.	4.2%
Quest Diagnostics, Inc.	3.9%
Chubb Ltd.	3.5%
Accenture PLC	3.4%
Omnicom Group Inc.	3.4%

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Fiduciary Management Inc.
Small Cap Equity Composite
12/31/2008 - 12/31/2018

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 %
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%
2017	15.42	14.49	14.65	171	0.84	11.12%	13.91%	$ 2,774.0	$ 25,322.0	10.96%
2018	-8.10	-8.83	-11.01	160	0.74	11.73%	15.79%	$ 2,220.4	$ 19,833.6	11.20%

*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 - 12/31/2018. 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 -12/31/2018. 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 $19.8 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	0.85%
$25,000,001-$50,000,000	0.80%
$50,000,001-$100,000,000	0.70%
$100,000,001 and above	0.60%

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.