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INVESTMENT STRATEGY OUTLOOK – SMALL CAP EQUITY

March 31, 2021

The FMI Small Cap portfolios returned approximately 12.6% in the March quarter compared to 12.70% for the Russell 2000 Index and 21.17% for the Russell 2000 Value Index. Relative to the Russell 2000, sectors that outperformed included Health Technology, Technology Services, and Electronic Technology. Underperforming areas included Producer Manufacturing, Finance, and Retail Trade. From an individual stock perspective, Robert Half International Inc., Insight Enterprises Inc., and Interpublic Group of Cos. Inc. were outstanding, while FirstCash Inc., TriMas Corp., and Houlihan Lokey Inc. lagged. Most stocks did reasonably well in the quarter; deeper-value names (many of suspect quality) and cyclical enterprises were standouts. Firms with a high probability of default, money-losing companies, and other highly-speculative stocks also continued to perform well. Recall that 2020 was a banner year for the most speculative stocks. Companies with over $1 billion in market value as of year-end 2020, who also lost money in 2019 (409 money-losing companies), gained on average 123% last year. When the other side of this stock market cycle has been completed, we believe most of these stocks will better reflect fundamental reality.

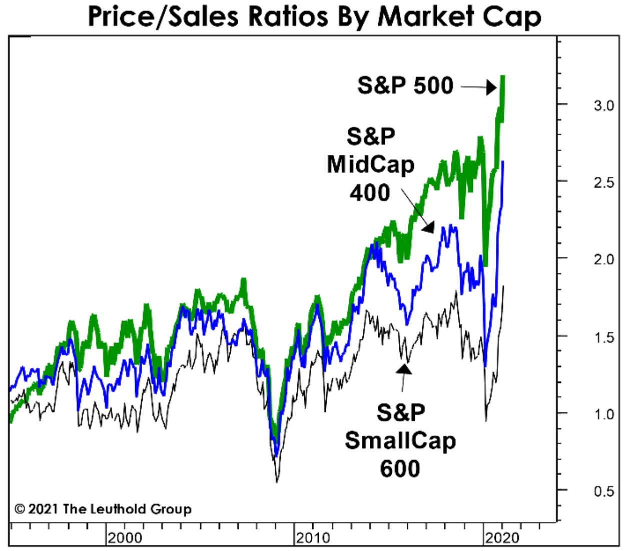
We lead this note with a reiteration of what we said in December. Vaccines are helping to drive COVID-19 into the background, economies are generally improving, and the outlook is brightening for revenue growth. This should favor value-oriented securities. The absence of generalized growth helped drive a high premium for those relatively few companies that were growing rapidly. There are still nearly ten million Americans out of work, and once the disincentive of a government check is removed, the expectation is that many people will rejoin the workforce. There is pent-up demand, and this should drive good GDP growth.

We also have to consider, however, the ramifications of unprecedented deficit spending. The U.S. government is set to borrow more money than it generates in tax receipts, pushing the deficit to likely exceed 20% of GDP this year, and the federal debt at least 30% greater than the total output of the economy. The U.S. has never had such a stretched balance sheet in non-war times. Someday the piper will have to be paid.

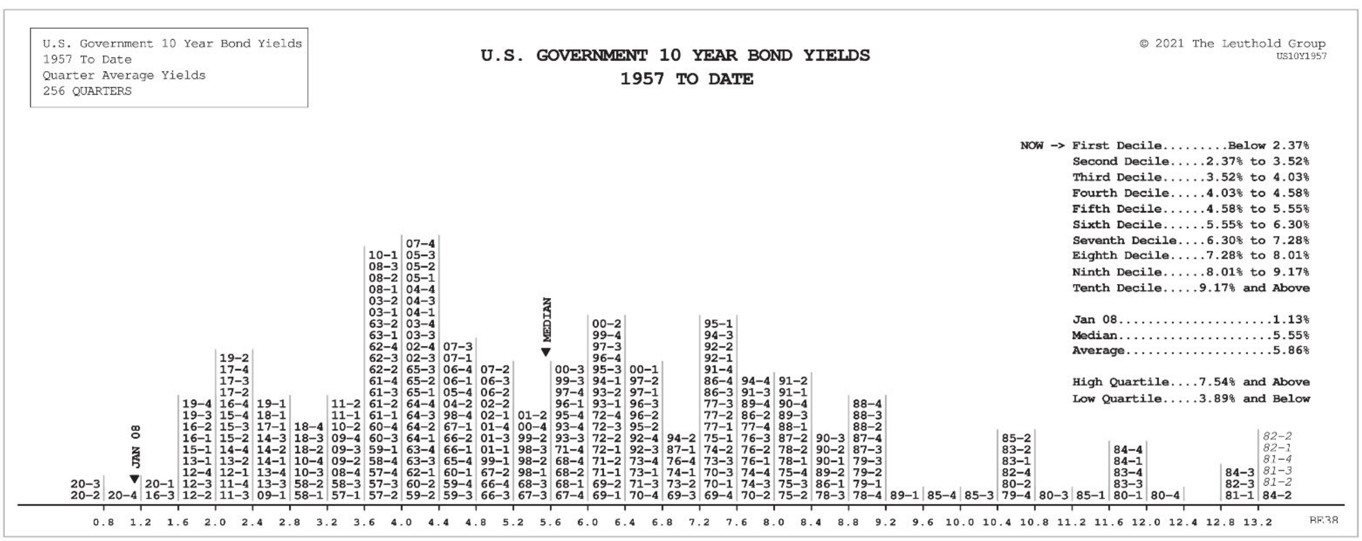
The "character" of the stock market is rambunctious, casino-like, and schizophrenic. Stocks rip up or down seemingly based on whether professional traders, CNBC, or the Reddit/Robinhood crowd deem it a "risk-on" or "risk-off" day. Social media-driven campaigns have perhaps mortally wounded short sellers. Short selling is a legitimate and useful endeavor as it helps with price discovery; however, if a loosely-organized mob can run up the stock of a low-quality, heavily-shorted business, it makes the profession untenable. At least one major hedge fund needed a multi-billion-dollar bailout after its short position in GameStop was attacked. Broken bets, at least so far, haven't curbed the chaotic action in the retail investor camp. Recall last year's head-scratching rally in the bankrupt rental car company, Hertz Corp. Trading around $20 per share in February of 2020, it filed for bankruptcy on May 22nd. The stock immediately went to $0.56. Retail traders, taking cues from popular sites on Redditt like WallStreetBets, sent the stock up tenfold in a month. Today, trading in the pink sheets, Hertz is at $1.72 -- still a highly-speculative price, considering the likelihood of equity investors getting zero in the restructuring.

Traders moving "baskets" of securities are causing stocks to lurch back-and-forth between various indices (growth or value) and subsectors (Special Purpose Acquisition Companies, or "SPACs," shorts, rate-sensitive financials, high-beta reopening stories, non-profitable tech, oil, renewables, high beta coronavirus beneficiaries, infrastructure, etc.), furthering the disconnection between individual stocks and underlying fundamentals. Stocks are viewed by many as pieces of paper, not fractional ownership of businesses. There might be a whole generation of investors who simply do not consider valuation at all in the selection of their investments. It's possible this multi-year phenomenon can continue. If so, investors can throw away the textbooks and simply follow momentum. Of course, we don't believe it will persist; there is no historical precedent, and it just violates common sense.

Most valuations are higher than at any time we have studied. Few would buy a company trading at 39.9 times trailing earnings (price-to-earnings), 27.7 times EBITDA[1] (enterprise value-to-EBITDA), or 6.6 times revenue (price-to-sales), yet this is what index investors are paying for the S&P 500 today.[2] It's similar for other market caps. The chart to the right depicts the median price-to-sales ratio for three S&P indices. Lately, around our firm, we've marveled at some Wall Street research reports that literally do not mention a stock's valuation. Many investors have a distorted view of how fast companies grow. Most would be surprised to learn that over the past decade, the median growth rates of the S&P 500 sales and earnings were 2.61% and 2.75%, respectively. Eventually, we expect that reality will be reflected in fundamental valuations.



Growth stocks underperformed in the quarter. Higher interest rates are perhaps the culprit, although meeting elevated expectations may also be a factor. The 10-Year Treasury yield rose to 1.74% from 0.93% at the start of the year. As the economy gains speed coming out of coronavirus-induced shutdowns and dormant money starts to get deployed within the banking system, inflation concerns may surface. As mentioned, we are seeing anecdotal evidence of inflation in several places. Perhaps this sets the stage for the long-awaited "normalization" of interest rates. Since 1957, the median 10-Year Treasury yield is 5.55%. As the following histogram reveals, today's level could rise 0.60% and still be in the *first decile*. We've reviewed Wall Street models for some growth companies that incorporate a cost of capital below 2%! Imagine what those long-term discount models would look like with a more normal 10% hurdle rate on equity capital and 5-6% on debt.



Inflation is in almost nobody's muscle memory. Very few investors were around in the early 1980s, the last time inflation was a real problem. Economies were much different back then. Natural resource dependency, labor mobility, supply

[1] Earnings before interest, taxes, depreciation, and amortization.

[2] Valuations are estimates based on the following scrubbing criteria: money losing companies are ascribed a 40 price-to-earnings (P/E) ratio to them (which is probably conservative) and those with P/E ratios greater than 100 are capped at 100. For P/S, those with greater than a 30 multiple are capped at 30x. We assign the same multiple for no sales. The EV/EBITDA calculation excludes financials, and uses a cap of a 200 multiple, while those with a negative EV/EBITDA receive a 20 multiple in the calculation.

chain efficiency, technology, and many other elements have fundamentally changed, making high inflation appear less likely than in the past. Nevertheless, warp speed increases in deficits and overall debt, low productivity, wanton Fed money printing, and complete political disfunction may help foster higher prices. Our companies are telling us their costs are rising. This could begin to change the interest rate environment. It is hard to believe, but the effort to bring inflation under control saw the Federal Funds Rate move from 5% in 1976 to 20% in 1980. Going from today's street-level rates to something even remotely close to the lower end of this range would certainly change the character of what works, and what does not, in the stock market. Nobody has a crystal ball, but the FMI portfolios are not built with the notion that interest rates will stay low forever. Our approach is to buy all-weather vehicles, but with a dollop of contrarianism. We remain optimistic that good-quality, reasonably-valued businesses with solid balance sheets will prevail over the long run. Following are a couple of ideas that reflect this strategy.

Insight Enterprises Inc. (NSIT)

(Analyst: Matt Sullivan)

Description

Insight specializes in digital innovation, cloud/data center modernization, and connected workforce and supply chain optimization. The company designs and implements an array of solutions from over 6,000 information technology (IT) vendors for more than 150,000 end customers including government organizations, businesses, and healthcare and education institutions. Insight derives 78% of sales from North America, 19% from Europe, the Middle East and Africa, and 3% from Asia-Pacific. In total, the company operates across 19 countries.

Good Business

- As one of the largest value-added resellers of necessary technology product and service solutions, Insight benefits from scale and global growth in technology without being exposed to the same obsolescence risk as technology manufacturers.
- Insight helps customers manage a complex IT environment in a cost-efficient manner.
- The company is focused on services and integrated solutions to customers, which should benefit margins and returns over time.
- Over the past five years the company has averaged a 12% return on invested capital (ROIC), exceeding its cost of capital.
- Its balance sheet leverage is low, and the business is easy to understand.

Valuation

- The stock trades at a significant discount to the Russell 2000 despite it being a better-than-average business.
- Insight is being valued at a low double-digit enterprise value-to-EBITDA multiple and, using our estimate for next year's earnings, a mid-teens forward price-to-earnings multiple.

Management

- Ken Lamneck was appointed President and Chief Executive Officer and a director in January 2010. From 2004 through 2009, he was President of the Americas at Tech Data Corp., and from 1996 to 2003, held various executive management positions at Arrow Electronics Inc. He currently owns around $29.4 million of Insight stock.
- Glynis Bryan joined Insight in December 2007 as Chief Financial Officer. Prior to joining Insight, Ms. Bryan served as Executive Vice President and CFO at Swift Transportation Co., Inc. from April 2005 to May 2007. Prior to joining Swift, she served as CFO at APL Logistics Ltd. in Oakland, California and in various finance roles at Ryder System Inc., including CFO of Ryder's largest business unit. She currently owns approximately $7.2 million worth of Insight stock.

Investment Thesis

As a reseller of IT solutions, the company gives investors exposure to technology growth without subjecting them to the short product cycles, cut-throat competition, and poor capital allocation decisions that are typically inherent in technology investments. We believe Insight has solid long-term growth prospects, and that it will continue to expand its margins over time by selling more services and solutions to end customers. Given the earnings growth potential and the company's ROIC profile, we view the current valuation as attractive.

Flowserve Corp. (FLS)

(Analyst: Andy Ramer)

Description

Flowserve is a leading manufacturer and aftermarket service provider of flow control systems, with sales of $3.7 billion. The company has two divisions: Flowserve Pump Division (pumps), with 72% of sales, and Flowserve Control Division (valves), with 28% of sales. Flowserve serves more than 10,000 customers in over 50 countries. End markets served include Oil & Gas (35%), Chemical (29%), General Industries (18%), Power (14%), and Water (4%). North America accounts for 37% of sales, followed by Asia Pacific (23%), Europe (22%), Middle East & Africa (12%), and Latin America (6%). The company's market cap is $5.2 billion.

Good Business

- Flowserve has respected brands and technical expertise across broad industry process applications, and a history of strong customer relationships with end users, engineering and construction companies, and distributors.
- A significant installed base with more than five million assets provides recurring aftermarket opportunities. The aftermarket accounts for one-half of sales. The products and services are used in mission-critical applications.
- As restructuring expenses have declined, operating margins have improved. Flowserve has become less working capital-intensive as it has grown.
- Net debt is at the lowest level since 2012. The leverage ratio is a relatively modest 1.35 times. Free cash flow (FCF) is abundant.

Valuation

- Flowserve trades for around 20 times depressed 2021 estimates and 10 times prior peak earnings. After the company completes a multi-year restructuring process, it is expected to be a better business than historically, and therefore, should garner a higher multiple.
- The company is being valued at a low-teens enterprise value-to-EBITDA multiples on 2021 and 2022 estimates.
- Flowserve converts approximately 100% of its net income into FCF. There should be ample room for share repurchases and dividends in the future.

Management

- Scott Rowe has been President and CEO since April 2017. Although the turnaround may take a little more time to complete, we have been impressed by his progress to date.
- There has been a much-needed wholesale upgrade of leadership directly reporting to Mr. Rowe, and multiple changeouts from the board.
- A large number of senior leaders now have FCF and working capital metrics as part of their incentive compensation benchmarks, which will be measured quarterly, rather than simply a year-end target.

Investment Thesis

Flowserve is in a far better place than it was just four years ago, aided by the implementation of self-help initiatives under new management which has taken, or is taking action to optimize its manufacturing footprint, improve (standardize) processes, invest in systems, reinvigorate innovation, and improve the capture rate of its large installed base. The company's long-term targets include revenue growth of 2% above the industry growth rate and achieving an operating margin of mid-teens, up from 10% in 2020. Flowserve is a higher-quality way to gain exposure to the out-of-favor energy space.

Our sincere thanks for your support of Fiduciary Management, Inc.

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Small Cap Equity Composite
12/31/2010 - 12/31/2020

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 %
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%
2019	27.14	26.17	25.53	119	1.83	12.44%	15.71%	$ 2,415.0	$ 22,609.9	10.68%
2020	4.40	3.60	19.96	97	1.49	25.98%	32.74%	$ 2,079.2	$ 16,284.2	12.77%

*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 - 12/31/2019. 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 - 12/31/2020. 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 $16.2 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.