FIDUCIARY MANAGEMENT, INC.
FMIFUNDS.COM

**FMI Shareholder Letter**
**March 31, 2025**

Dear Fellow Shareholders:

In recent shareholder letters, we have been highlighting market anecdotes illustrating speculative behavior across financial markets. Some of that excess has begun to unravel. U.S. stock markets came under pressure in the first quarter, with the S&P 500 Index and Russell 2000 Index falling 4.27% and 9.48%, respectively. Constantly changing trade policies and newfound skepticism around the artificial intelligence (AI) boom helped fuel the pullback. Amidst heightened uncertainty, consumer confidence fell to a 12-year low, as concerns about inflation and recession risks took a toll. International stock markets fared much better (MSCI EAFE Index +2.89% in local currency, +6.86% in USD), however, as deteriorating U.S./ Ukraine relations helped catalyze new defense spending and stimulus plans in Europe, unexpectedly led by Germany, which has historically been more fiscally conservative. We are encouraged to see value stocks outperforming growth stocks in both the U.S. and abroad thus far in 2025.

After a long period of U.S. stock market dominance, the March quarter showed a reversal. While it is convenient to blame President Trump's trade war for much of the U.S. malaise, there is more to the story than just a chaotic, on-again, off-again tariff fight with the country's largest trading partners. It's important to remember that when you combine a crescendo of unwavering optimism with speculative activity and extended valuations (one of the most expensive stock markets on record), it doesn't take much for volatility to increase.

For some historical perspective, the following table published by *The Leuthold Group* compares valuation and economic vital signs today compared with the peak of the 2000 tech bubble. The tale of the tape is eerily similar. Note that market cap as a percentage of GDP, operating margins, median normalized valuations in mid-to-large capitalizations, inflation expectations, and federal deficits are all significantly higher today than they were back then. While we are hopeful that history will not repeat itself with a nearly 50% drop in the S&P 500, elevated valuations do increase the market's vulnerability to surprises and negative shocks. Suffice it to say that downside risks may not be fully priced into current valuations. It could be a *very* bumpy road ahead.

**Today Versus The Y2K Technology Bubble Peak (Month-End)**

| | Feb 2000 | Feb 2025 |
|---|---|---|
| **Stock Market** | | |
| S&P 500 Index | 1366 | 5955 |
| S&P 500 P/E on 5-Yr. Normalized EPS | 30.2x | 30.7x |
| S&P 500 P/E on 12-Mo. Forward EPS | 21.9x | 21.5x |
| S&P 500 Dividend Yield | 1.23% | 1.30% |
| Ratio, 10-Yr. Yield to S&P Fwd Earn Yield | 1.41 | 0.91 |
| Market Capitalizaiton % GDP | 137% | 197% |
| S&P 500 4-Qtr. Operating Margin | 7.5% | 11.6% |
| **"Average" Stock** | | |
| S&P 500 Median Normalized P/E | 22.2x | 29.4x |
| S&P MidCap 400 Median Normalized P/E | 17.7x | 24.9x |
| S&P SmallCap 600 Median Normalized P/E | 21.2x | 21.0x |
| **Other Assets** | | |
| 10-Yr. Treasury Bond Yield | 6.42% | 4.24% |
| 10-Yr. Treasury Bond Yield "Fair Value" | 5.55% | 5.82% |
| Spot Gold | 293 | 2835 |
| Median Priced Existing Home | 136,700 | 402,000 |
| **Economy** | | |
| Unemployment Rate | 4.0% | 4.1% |
| Consumer Price Inflation | 2.7% | 3.0% |
| Misery Index (Unemployment + Inflation) | 6.7% | 7.1% |
| 5-Yr. Cumulative Increase In CPI | 12% | 23% |
| 12-Mo. Federal Deficit/Surplus % GDP | +1.5% | -7.2% |
| **Confidence/Expectations** | | |
| 1-Yr. Inflation Expectation (U. of Mich.) | 2.9% | 4.3% |
| Consumer Confidence - Present Situation | 180.1 | 136.5 |
| Consumer Confidence - Expectations | 114.6 | 72.9 |
| Small Business Optimism Index | 103.4 | 102.8 |

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Nevertheless, we are reassured to see some increasing discernment in the market. An entire generation of investors have seemingly known only one reality: growth stocks outperform, technology wins, and speculative assets like cryptocurrencies are limitless. For most of the last two years, momentum has dominated. Individual security selection has been an afterthought. Fortunately for value investors, nothing goes straight up forever. Sooner or later over-exuberance has consequences.

Several of the top-performing themes of 2023 and 2024 have started to crumble. Momentum has collapsed. The Magnificent 7 are off 16.0% in 2025, with Tesla and Nvidia down 46.0% and 27.5% from recent highs. AI high-flyers like Super Micro

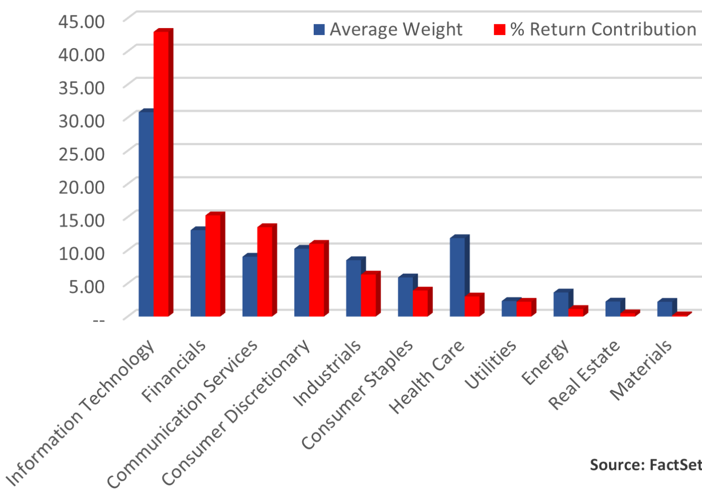
and Palantir have fallen 43.2% and 32.3%. Memes and most liquid shorted stocks have both come under pressure. Cryptocurrencies lost *$1 trillion* in market cap since December, with MicroStrategy (the bitcoin-sensitive equity we featured in our last shareholder letter) down 41.5% from its 52-week high. The chart on the left illustrates a stark similarity between the direction of travel for technology and cryptocurrencies. It speaks to basket traders' lack of differentiation and their propensity to chase what's been working.

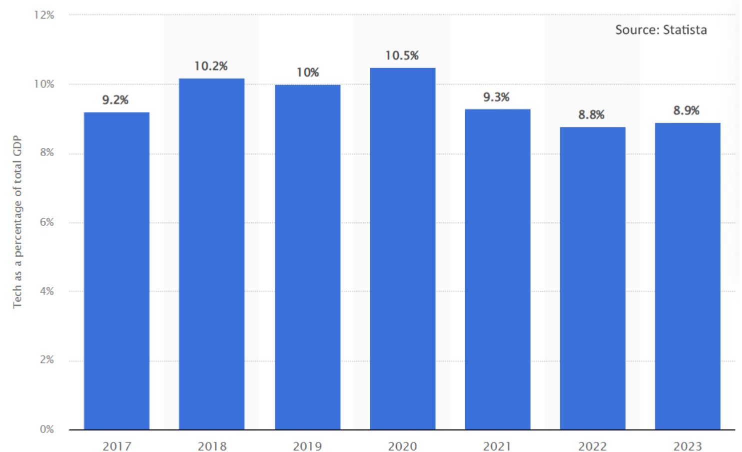
And here lies the million-dollar question: As the market digests downside risks and the economic outlook gets increasingly murky, what kind of businesses will investors want to own? At FMI we take comfort holding portfolios of durable businesses trading at discount valuations; well-financed, profitable companies generating strong cash flow. We welcome the increased market volatility – with it will come opportunities.

***Doomed Love Affair? Growth & Technology***

While we are significant users and believers in technology, we question whether the stock market has taken its love affair too far. The illustrations below are an interesting frame of reference. The bar chart on the right depicts the technology sector as a percentage of U.S. GDP, which has remained relatively stable, averaging less than 10%. We expect the 2024 print to increase modestly, given the AI frenzy, but will be partially offset by weaker technology growth elsewhere. In reality, AI has sucked the air out of the room and pulled investment away from other areas of technology. The graph on the left depicts technology as a percentage of the S&P 500, which has skyrocketed in recent years and accounted for over 30% of the weighting in the index, and 40% of the contribution to performance in 2024. The disconnect is clear.

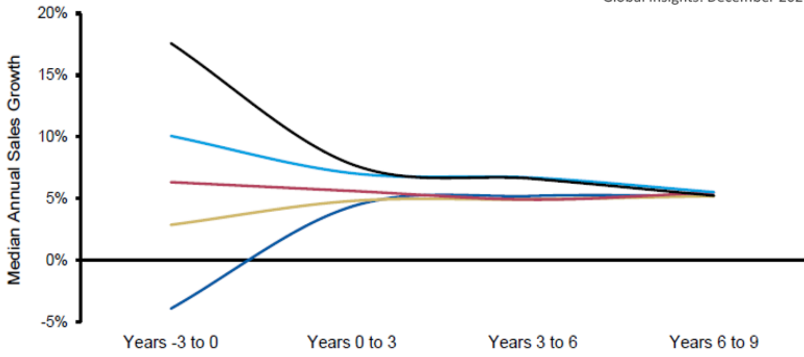
It may also prove difficult for these beloved technology companies to meet the elevated growth expectations embedded in current valuations. Morgan Stanley tried to tackle the question: "How likely is it that a company that has grown rapidly in the



**Regression Toward Mean in Sales Growth 1962-2022**

Source: Morgan Stanley Investment Management - Counterpoint
Global Insights: December 2024




*Source: Counterpoint Global, Compustat, and FactSet.*
*Note: Minimum of $1 million of sales in 1962 dollars.*

3-year sales growth rates for U.S. public companies on major exchanges from 1962-2022. Lines represent quintiles, and are based on the compound annual growth rate of sales for all companies three years before the starting point (year 0). Population of quintiles held constant in quintile.

past will continue to grow at the same, or a similar, rate in the future?" As depicted on the left, fast-growing businesses (10% or 20%) will slow in subsequent years, regressing towards the mean. Increased competition, dynamic industries, and changing technologies all play a role. While there will always be exceptions to the rule, history would suggest that the sustainability of high growth rates is rare and often finite.

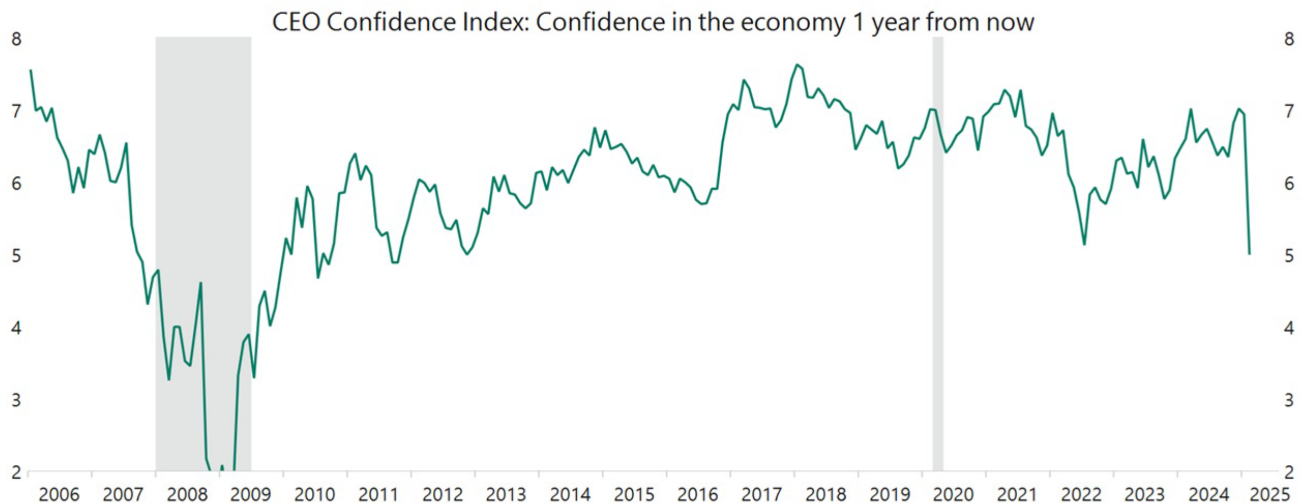
***Tariff Tantrum***

In the U.S., Trump's whipsaw approach to trade policies has created a difficult environment for companies to navigate (Confidence Index chart below). CEOs have very little visibility – waking up to significant tariffs one day and none the next. This makes it especially tough for planning purposes and has caused businesses to tap the brakes on hiring and investment.

Over the long-term, protectionism has a dismal economic track record. Nearly every economist we highly regard believes that tariffs are damaging to economic growth, operating instead like a tax on the imposing country's citizens, which is likely to be inflationary. The risk of stagflation (weak growth and high inflation) increases with widespread tariffs and could make for a challenging economic backdrop. The U.S. may believe it has less to lose in a global trade war because it exports and imports less than the other top 20 economies (as a percentage of GDP), but it would be detrimental for everyone involved if this continues to escalate. So, why would the Trump administration push tariffs?

- To encourage U.S. companies to produce in the U.S.
- To encourage foreign companies to produce in the U.S.
- To raise tariff revenue amidst a growing U.S. fiscal deficit
- To force other countries to do things they otherwise would not do

It is debatable whether the tariff moves during the first Trump administration accomplished either of the first two bullet points. Only time will tell if this term is different. We are skeptical, mainly because of the manufacturing cost advantages held by many foreign countries. While some automated manufacturing of specialized products may come back to the U.S., the idea that labor-intensive or low-value products should be made domestically with high-cost labor is not logical. Tariff revenue will increase, at what ultimate cost to the economy (and the tax base)? The last bullet point may get to



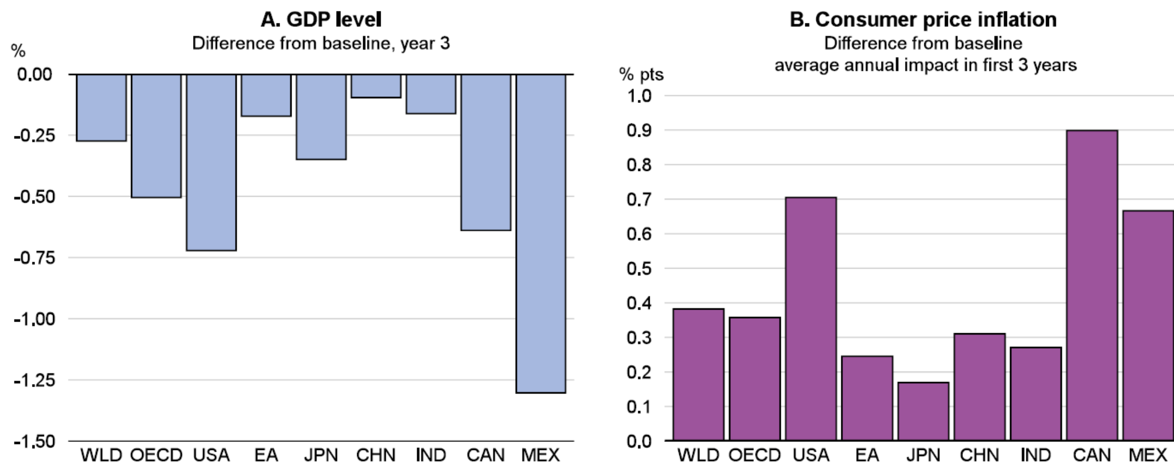

**Sources: Chief Executive Magazine, Bloomberg, Macrobond, Apollo Chief Economist**

the crux of this administration's tariff policy. Take Mexico/Central America, for example. Illegal border crossings have reduced significantly since Trump threatened/imposed tariffs. Roughly 80% of Mexico's exports go to the U.S., accounting for approximately 40% of Mexico's GDP. Yet only a fraction of U.S. GDP comes from exports to Mexico. This gives Trump meaningful leverage, and he is all about the deal.

The Organization for Economic Co-operation and Development (OECD) has modeled the fallout of a bilateral 10% tariff globally in the charts below. If 20% or 25% tariffs (or more) are here to stay, it could get significantly worse. Trump's endgame remains to be seen.

**Further trade fragmentation would harm global growth prospects**

Simulation of a rise of 10 percentage points in US tariffs on non-commodity imports from all countries and 10 percentage points higher tariffs on non-commodity imports from the United States by all countries




Note: Illustrative scenario of the impact of 10% US tariffs on non-commodity imports and retaliation from all countries. See technical appendix for details of the shocks considered.
Source: OECD calculations using the NiGEM global macroeconomic model and the OECD METRO model.

***Tanks & Banks***

After years of slower earnings growth, widening discounts, and underperformance versus U.S. stock market counterparts, international equities are now surging. Defense and rate-sensitive financials were the top performing themes in Europe, as tracked by Goldman Sachs in the first quarter, up a remarkable 69.7% and 26.6%, respectively. The *Financial Times* reports that asset managers are now racing to set up European defense ETFs (i.e. basket trading), with the first fund launched this March already attracting over $700 million in inflows.

Germany's stunning pivot has invoked investors' animal spirits. After two years in an economic recession (2023 and 2024), a new incoming German government broke with recent history by announcing defense and infrastructure spending that could exceed €1 trillion over the coming decade. The EU Commission is also proposing a "ReArm Europe" plan, calling for €800 billion of national spending on defense. FMI's exposure to defense has historically been fairly limited, with concerns around business quality (reliance on government spending), growth prospects, and valuation. After the recent stock moves and blanket basket buying, we believe the current valuations reflect very high expectations.

FMI has also historically been underweight financials, and banks in particular, given their high leverage, opaque balance sheets, and low margins. We pick our spots, preferring financials with more competitively advantaged business models, such as insurance, money managers, rental companies, payment networks, and financial processors, which often have better return profiles and lower leverage. When rate-sensitive banks rally, we typically give up some relative ground. The MSCI EAFE has a very large weighting in levered financials (majority in banks), at 25% of the index. During the past 12 months, financials advanced by ~25%, accounting for nearly all of the index's total return. FMI International's finance weighting is less than half that of the benchmark, with some differentiated banking exposure in Southeast Asia (DBS Group Holdings Ltd.) and the UK (Lloyds Banking Group PLC), with additional holdings in payment solutions (Edenred SA) and equipment rental (Ashtead Group PLC). We exited our P&C insurance exposure (Arch Capital Group Ltd.) last year on valuation.

As a reminder, all the FMI portfolios have an active share above 90%. Active share measures the difference in holdings between a portfolio and its benchmark, falling between 0% and 100%. Zero indicates a pure passive strategy while a higher reading indicates more active stock picking. To beat the market, we believe you have to do something different, even if it means looking out of favor at times. We go where we find the best opportunities and have successfully executed a disciplined, value-oriented process for over 45 years. Through deep-dive fundamental research, we aim to outperform our respective benchmarks while taking on less risk by relentlessly focusing on downside protection. We are built for tough markets and look forward to navigating what could be a very volatile stretch. Buckle up!

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Outlined below are a few portfolio holdings that we think can compound value over time:

***<u>FirstCash Holdings, Inc. (FCFS) – FMI Common Stock Fund</u>***

FirstCash is one of the largest pawn operators in the world with around 3,000 total stores. We like the pawn business because it's a defensive, needs-based business. Pawn demand typically strengthens as economic activity declines, which is an attribute not shared by many businesses. Pawn loans are also small in size, have short maturities, and are fully collateralized at attractive loan-to-values, making them very low-risk loans. Many states have adopted regulations that make it difficult to open new pawn stores, which insulates incumbent players from new competition. This leads to attractive returns on invested capital for industry participants. FirstCash has been a consolidator within the fragmented pawn industry in both the U.S. and Mexico. We expect this to continue. Therefore, even though it's been a favorable microeconomic environment for pawn operators, we believe the company should be able to generate strong growth over the mid-to-long term. The shares are trading at relatively undemanding mid-teens earnings multiple.

***<u>Allegion Public Limited Co. (ALLE) – FMI Large Cap Fund</u>***

Allegion is a leading global provider of security products and solutions, with a particularly strong presence in the attractive U.S. non-residential markets. While these markets are economically sensitive (cyclical) and many are currently weakening, the industry has grown reliably over time with the installed base of buildings and homes (approximately half of sales driven by aftermarket), rising desire for safety, security, and privacy, and increasing adoption of electronic products which enable enhanced efficiency, safety, and control. The commercial electronic security hardware market is dominated by three players (ASSA ABLOY, Allegion, Dormakaba), who are estimated to control 70-80% of the global market share. Allegion's trusted brands (Schlage, Kryptonite, Stanley Access Technologies, etc.), large installed base, efficient manufacturing/service levels, technical and specifications expertise, and channel relationships built over decades make the company's position in these markets very difficult to replicate. The stock is trading well below the market, which we view as attractive given its above-average business quality.

***<u>Sodexo S.A. (SW FP) – FMI Global and International Funds</u>***

Sodexo is a leading caterer and facilities manager. The company is headquartered in France and controlled by the Bellon family. By geography, revenue is split 48% North America, 35% Europe, and 17% Rest of World. By service line, revenue is split 68% food services and 32% facilities management services. As one of the largest players in the industry, Sodexo has procurement advantages over smaller operators and self-operators. Smaller operators and self-operators represent over 50% of the market. As a result, Sodexo has a long runway to grow market share. There is also margin improvement potential driven by operating leverage and supply chain efficiencies. The stock has underperformed recently due to self-inflicted execution issues. We view these issues as temporary and are confident that management can improve performance. There is significant upside from earnings growth and multiple expansion. The valuation has fallen to a historical low and is at a sizeable discount to the market and competitors.

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Thank you for your continued support of the FMI Funds.

## Disclosure Information

*Performance data quoted represents past performance; past performance does not guarantee future results. 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 www.fmifunds.com 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.*

Securities named in the Letters to Shareholders, but not listed in the Schedules of Investments are not held in the Funds as of the date of this disclosure. Portfolio holdings are subject to change without notice and are not intended as recommendations of individual securities. The referenced securities are owned by the Funds on March 31, 2025 as follows:

FMI Common Stock Fund - First Cash Holdings Inc. - 3.9%
FMI Large Cap Fund - Allegion Public Limited Co. - 2.0%
FMI Global Fund, International Fund, and International Fund II - Sodexo S.A. - 3.6%, 4.2% and 4.2% respectively.

This report is not authorized for use as an offer of sale or a solicitation of an offer to buy shares of the Funds unless accompanied or preceded by the Funds' current prospectus.

Annual operating expenses for FMIMX, FMIUX, FMIHX, FMIQX, FMIJX, FMIYX, FMIFX, and FMIGX as of the Prospectus dated 1/31/25 are as follows: 0.98%, 0.85%, 0.84%, 0.70%, 0.94%, 0.80%, 0.90%* and 0.90%*, respectively.

*Note that the annual operating expenses for FMIFX and FMIGX are 1.12% and 1.09% respectively, before the investment adviser's voluntary reimbursement such that the annual operating expenses do not exceed 0.90% for each, which will continue at least through January 31, 2026.

Risks associated with investing in the Funds are as follows:

FMI Large Cap Fund: Stock Market Risk, Medium and Large Capitalization Companies Risks, Value Investing Risk, Foreign Securities Risk (fluctuation of currency, different financial standards, and political instability), Liquidity Risk, and Tax Law Change Risk.

FMI Common Stock Fund: Stock Market Risk, Medium and Small Capitalization Companies Risks (which includes the potential for greater volatility and less financial resources than Large-Cap Companies), Value Investing Risk, Foreign Securities Risk (fluctuation of currency, different financial standards, and political instability), Liquidity Risk, and Tax Law Change Risk.

FMI International Fund: Stock Market Risk, Value Investing Risk, Foreign Securities Risk (fluctuation of currency, different financial standards, and political instability), Geographic Concentration Risk, Currency Hedging Risk, Large Capitalization Companies Risk, Liquidity Risk, and Tax Law Change Risk.

FMI International Fund II – Currency Unhedged: Stock Market Risk, Value Investing Risk, Foreign Securities Risk (fluctuation of currency, different financial standards, and political instability), Geographic Concentration Risk, Large Capitalization Companies Risk, Liquidity Risk, and Tax Law Change Risk.

FMI Global Fund: Stock Market Risk, Value Investing Risk, Foreign Securities Risk (fluctuation of currency, different financial standards, and political instability), Emerging Market Risk, Geographic Concentration Risk, Large Capitalization Companies Risk, Liquidity Risk, New Fund Risk, RIC Qualification Risk and Tax Law Change Risk.

For details regarding these risks, please refer to the Funds' Summary or Statutory Prospectuses dated January 31, 2025.

The Funds does not directly invest in Bitcoin or other cryptocurrencies. Bitcoin and other cryptocurrencies are a relatively new asset class and are subject to unique and substantial risks.

The Standard and Poor's 500 Index (S&P 500) consists of 500 selected common stocks, most of which are listed on the New York Stock Exchange. The S&P's Ratings Group designates the stocks to be included in the Index on a statistical basis. A particular stock's weighting in the Index is based on its relative total market value (i.e., its market price per share times the number of shares outstanding). Stocks may be added or deleted from the Index from time to time.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index. The Russell 2000 Value Index includes equities that exhibit value characteristics and the Russell 2000 Growth Index includes equities that exhibit growth characteristics.

The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada. The MSCI EAFE Index consists of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom. Index results are inclusive of dividends and net of foreign withholding taxes. The reported figures include reinvestment of dividends and capital gains distributions and do not reflect any fees or expenses.

The MSCI World Index is a free-float adjusted market capitalization index that measures large and mid-cap performance of developed market countries which include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the UK and the US. With 1,395 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

MSCI EAFE is a service mark of MSCI Barra.

The Nasdaq Index is a market capitalization-weighted index of more than 2500 domestic and international stocks listed on the Nasdaq Stock exchange that is heavily weighted toward the technology sector.

The Nikkei 225 Index is a price-weighted index composed of Japan's top 225 blue-chip companies traded on the Tokyo Stock Exchange. The Nikkei is equivalent to the Dow Jones Industrial Average (DJIA) Index in the United States.

All indices are unmanaged. These indices are used herein for comparative purposes in accordance with the Securities and Exchange Commission regulations. It is not possible to invest directly into an index.

## GLOSSARY

**CPI - Consumer Price Index** measures the monthly change in prices paid by U.S. consumers. The Bureau of Labor Statistics (BLS) calculates the CPI as a weighted average of prices for a basket of goods and services representative of aggregate U.S. consumer spending.

**GDP - Gross Domestic Product** is the monetary value of all finished goods and services produced within a country's borders in a specific time period.

**EPS - Earnings per share** is a commonly used measure of a company's profitability. It indicates how much profit each outstanding share of common stock has earned. Generally speaking, the higher a company's EPS, the more profitable it is considered to be.

**P/E ratio - Price-to-earnings ratio** is the ratio for valuing a company that measures its current share price relative to its per-share earnings. The trailing P/E ratio is calculated by dividing the current share price by per-share earnings over the previous 12 months and the forward P/E ratio estimates likely per-share earnings over the next 12 months.

**Yield** is the income returned on an investment, such as the interest from holding a security. The yield is usually expressed as an annual percentage rate based on the investment's cost, current market value, or face value. An investor can look at yield as gross yield, which does not deduct taxes and expenses, or net yield, which deducts those expenditures.

Reference definitions found at Investopedia.com

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