

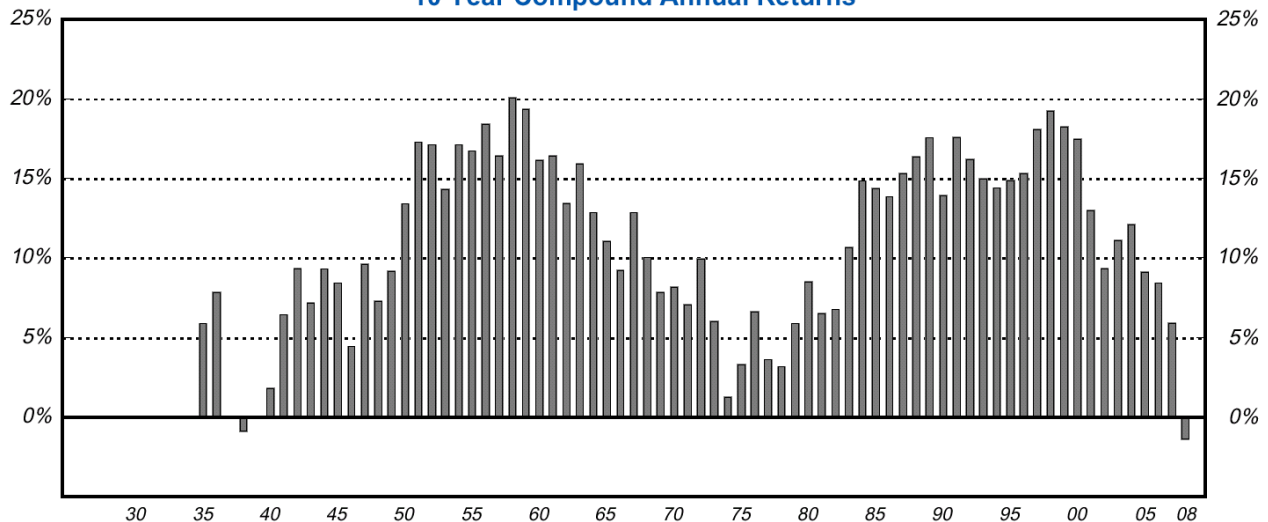
## INVESTMENT STRATEGY OUTLOOK – LARGE CAP EQUITY

Quarter Ended December 31, 2008

### *December 31, 2008*

Stocks declined significantly in the December quarter. Fiduciary Management, Inc. large cap portfolios fell about 18% compared to the Standard & Poor's 500 Index's decline of 22%. For the calendar year, FMI large cap portfolios declined approximately 27%, compared to the fall of 37% for the S&P 500. The bear market of 2008 was the second worst since the 1930s and the first time since that era that the trailing 10-year return for large cap stocks has been negative. Investors in the S&P 500 earned a -1.4% compound return over the past ten years, one of the worst periods on record. The following chart depicts every rolling 10-year period since 1935. The good news is the poor 2008 returns are history; performance following difficult decades is typically quite good. According to the Leuthold Group, when 10-year annual total returns fall to 1% or less, the next ten years historically produced an average cumulative return of 183%.

### Large Capitalization Stocks 10 Year Compound Annual Returns



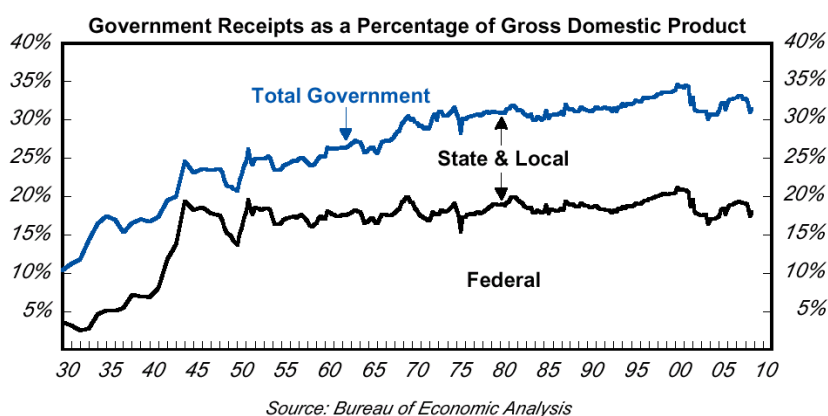
*Source: Standard & Poor's Corporation*

A few weeks ago it became apparent that the newspapers, magazines and broadcasters were essentially done writing anything positive. Given today's many economic challenges and the sorry state of "old" media, perhaps their sour spin is not surprising. Wall Street economists, strategists and analysts, typically an optimistic crew, have also become uniformly negative. It seems like they are in a contest to see who can make the most egregiously downbeat projection. One wag described a Street strategist, saying, "He is trying to out-Whitney everybody." This is in reference to Oppenheimer's Meredith Whitney, who has made a name for herself by being exceptionally bearish toward Citigroup. To summarize the pundits, we are now facing unprecedented weakness in housing, consumer spending, employment, manufacturing, auto sales, shipping, commodity prices, business investment, credit quality, GDP growth, credit cards, commercial loans, securitizations, spreads, government tax receipts and the stock market. While many of these are undisputable realities as 2008 winds to a close, investors must decide whether today's negatives will be temporary or long lasting. Are government policy initiatives going to prove effective or permanently destructive? Finally, what are the positives?

This letter will focus on the latter but first we must acknowledge that the current environment is indeed troubling and much worse than we anticipated. The policy responses so far have been haphazard, expensive,

counterintuitive and rife with moral hazard. The Fed is printing money at a dangerous rate and it appears that our government leaders, and perhaps the populace, have lost faith in free market economics. The knee-jerk reaction from policymakers seems to be more intervention, more spending and more bureaucracy. We are rewarding poor lenders with additional capital and we are encouraging borrowing by people who do not have the wherewithal to repay, even while excessive borrowing (and spending) was what got us in trouble in the first place. We are making commitments without the money to cover the obligations. We are subsidizing companies that either acted irresponsibly or can't compete, and penalizing successful companies and individuals who played by the rules. And we are taking it on faith that the Fed, who presided over irrational monetary policy that either led to or accentuated a bubble in both equities and real estate, is going to first pump-up the system to avoid deflation, then at just the right moment flip into a restrictive mode to avoid inflation.

This view may sound a touch cynical and perhaps even paranoid. There are many others who feel massive government intervention is necessary to avoid a 1930s-style depression. On top of the many programs and hundreds of billions of dollars of commitments from Paulson, Bernanke and company, President-elect Obama's team recently floated an \$850 billion spending package, reminiscent of an FDR-era stimulus. The theory is to increase government spending to make up for the fall in private spending. When things are back to normal, the thinking goes, government backs off and the private sector takes up the slack. The accompanying chart of federal spending as a percentage of Gross Domestic Product doesn't really support the notion that this part of the bargain will be upheld.



The various interventions are supposed to increase liquidity in order to purchase assets that are currently unmarketable, from mortgage-backed securities to leveraged loans and structured investment vehicles. The next step, according to the Fed/Treasury playbook, at least as we read it, is debt restructuring. There is far more debt outstanding than can be repaid given today's conditions, so these obligations simply have to be reduced. It's analogous to a corporate Chapter 11 restructuring. How this debt restructuring will transpire remains to be seen. Certainly one thing the government could do for corporations is eliminate the tax penalty for retiring debt at a discount to par. Lenders could also forgive or modify terms. Companies could default. However it happens, the restructuring process is necessary before the conditions can facilitate any real credit creation.

Despite the enormous challenges facing the economy today, and with knowledge that it will take some time to return to a fundamentally sound position, the extraordinary decline in stock prices seems to discount an overly-dire outlook. John Templeton used to describe the search for "points of maximum pessimism." This feels like just such a time. We anticipate stocks being higher in two or three years, despite what is likely to be an ugly near term economic and corporate earnings environment. Extreme volatility may also characterize the market for the next several quarters. From 1950 to 2000 there were 27 days when the S&P 500 moved up or down more than 5%. Since October 1 of this year there have been a remarkable 26 days. The VIX index, which measures volatility and is a proxy for fear, reached an all-time high in November. Pessimism is pervasive but there are a number of longer-term positives that may emerge from this difficult period that will likely bolster the economy, the stock market and society. Of course no one knows the true end of a bear market until long after the fact, but we are encouraged by the 22% gain in the S&P 500 since its intraday low on November 21.

Below we have articulated a few of the positives that may evolve from the 2008 turmoil.

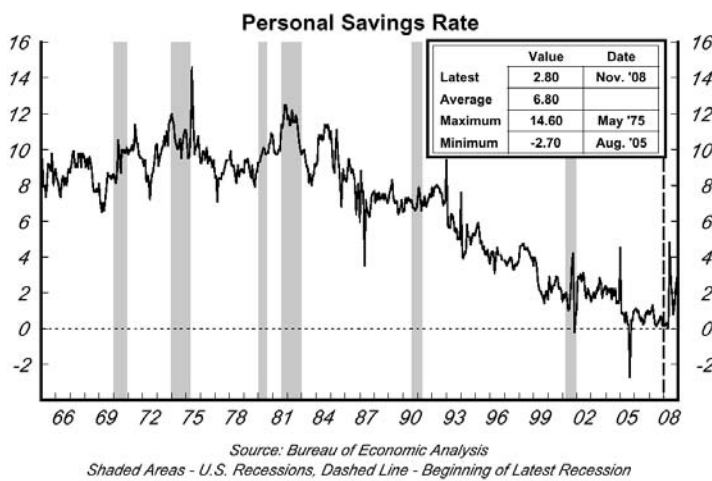
### ***Cost Cutting Sets the Stage for Profits Recovery***

The dramatic decline in business conditions has ushered in an aggressive cost cutting attitude. In the last several weeks we have observed literally hundreds of companies announcing restructurings and expense reduction measures. Despite so-called Lean Manufacturing, Six Sigma, Kaizen, or any other efficiency measures, expansionary phases nearly always lead to excesses. Tough times remind managers they can do more with less. Higher unemployment is a painful short-term byproduct but the alternative is worse (think Japan over most of the past two decades). Inventories are also being wrung out of the system at a rapid clip. Overall corporate margins peaked in late 2006, declined moderately in 2007 and are down sharply in 2008. They will likely be down again in 2009 but we believe the conditions will be ripe for a recovery in 2010-2011. A dramatic decline in input costs (energy, steel, copper, etc.) will also aid the recovery.

### ***Increased Consumer Savings and More Sensible Spending Create Sustainable Growth***

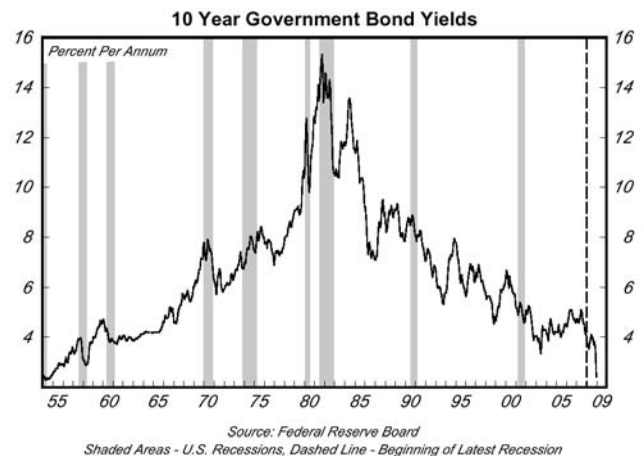
To everyone who has wondered how we could continue to consume more than we earn, the answer is that we can't. Consumers splurged for a long time as we borrowed against inflated asset values and spent more than our

incomes, but that game is over. The savings rate fell to below zero percent in recent years but is already back into the 2-3% range. Policymakers are deathly afraid that this figure will grow dramatically as consumer fear builds. In the short run, a higher savings rate does depress GDP growth, but in the long run, a healthy savings rate provides the internally generated capital to grow in a sustainable fashion. This will also do wonders to help protect our currency down the road, which may wobble as we try to pay for all the new spending programs the government is implementing.



### ***Zero Percent Interest May Do the Trick***

The 10-year Treasury bond yield recently hit 2.04%, the lowest yield in over 60 years. Three months or shorter maturity Treasury bill yields were actually below zero in late December, an all time low. That's right, you pay for the privilege of having the government hold your money! Zero percent may finally do the trick. That is, it may finally get institutional investors to begin to take some risks, extend credit to worthy borrowers, purchase some of the assets that are stranded, and get the credit gears of the economy turning again. The delicate balancing act is to have all of this transpire without bastardizing the currency or reigniting asset or price inflation.



### ***The Industrialization of the Rest of the World Still Awaits***

The "super cycle" in commodities and infrastructure spending that characterized the headlines less than a year ago are a distant memory today. We haven't heard from Matt Simmons (the peak oil guy) in several months and the Goldman Sachs analyst, who called for \$300 per barrel earlier in 2008, is now looking for \$25. Other commodities are down over 50%. Infrastructure cancellations and delays recently hit \$115 billion, according to Morgan Stanley, which compares to a normal year of \$15 billion. Despite this euphoria-to-despair outlook for commodities and infrastructure, the conditions that gave rise to the original thesis are largely intact. As long as a general trend toward market economics continues throughout the world, tens, if not hundreds of millions of people will, over the next decade, migrate from subsistence poverty toward middle class. The transportation,

water, mineral, and energy needs of the countries where these people live are tremendous. The genie is out-of-the-bottle, so to speak; having experienced a taste of the better living conditions infrastructure expenditures can yield, there will be no going back. Now that input costs are plummeting, including financing costs, the conditions are fertile for growth.

### ***“Best and Brightest” Going to Greener Pastures***

For two decades many of our best and brightest young people trudged off to become bankers, analysts, quants, hedge fund managers, lenders, mortgage brokers, real estate speculators, and wealth managers. Today, tens, if not hundreds of thousands of people are being laid off as it becomes clear that there is massive excess capacity in a wide variety of financial services. The golden age of finance may be over, which might not be a bad thing. Young people will rethink their plans and more will head toward chemistry, biology, nanotechnology, electrical engineering, physics, marketing, sales, logistics, teaching and the trades. In short, they will go to the real economy. The current turmoil may well remind everyone that the primary function of the financial economy is to help facilitate the real economy, rather than act as an end unto itself.

We are fortunate to live in a country where one’s lot in life is not cast in stone; many opportunities exist to take advantage of changing conditions. Recently we came across an interview of George Shultz, the former Secretary of State, discussing why he is optimistic about America’s future. “There is the ingenuity, the flexibility, the strengths of the national economy. We are so blessed with human talent and resources.” Regarding the American people themselves, “They have intelligence, integrity and honor.”

### ***Back-to-Basics Movement***

In 1985 there were 40 hedge funds. By 2007, there were over 13,000. Private equity and other alternative investment funds also proliferated dramatically, particularly over the past decade. Many of these investment vehicles depended on leverage or impossibly complex strategies to earn a respectable return. The housing bubble also created a great number of dubious careers and expectations. It is very difficult to understand the value added in a synthetic collateralized debt obligation (CDO) squared derivative or a hedge fund with a “two and twenty” compensation structure, levered five-to-one that uses supercomputers to trade thousands of shares of thousands of stocks by the millisecond. The heyday of these activities has passed, at least for a long while (according to one source, 3000 hedge funds have already closed). Perhaps the realization that money doesn’t come easily, combined with tougher economic times, will result in a back-to-basics movement. We envision a less flamboyant attitude on the part of CEOs, money managers and other leaders, which could result in a healthier attitude about a number of things such as compensation, sacrifice, values and so forth. Maybe boards and shareholders will realize that hired guns who put little of their own money at risk do not deserve to get paid like entrepreneurs who risk everything to be a success. Maybe a society that starts to live within its means will take conservation more seriously. Perhaps we might be lucky enough to see a society that understands that government doesn’t create wealth, the private sector does. A tough employment market may result in job creators being valued rather than vilified (and taxed).

### ***Valuations Attractive...Buffett is Buying!***

The old bromide, “nothing cures low prices better than low prices” is certainly true today. As we mentioned in our interim October letter (see [www.fiduciarymgt.com](http://www.fiduciarymgt.com)), valuations are attractive for those who have a long-term investment time horizon. There is a lot of cash on the sidelines. We are officially 12 months into the recession, one that looks very grim. The longest postwar recession was 17 months and we wouldn’t be surprised if this one lasted longer. Still, the stock market often rises six months to a year in advance of a turn in economic fundamentals. On October 17, Warren Buffett made a rare call-to-arms, saying he is buying American stocks and you should too. We are listening.

Thank you for your support of Fiduciary Management, Inc.

**Fiduciary Management Inc.  
Large Cap Equity Composite  
12/31/2000 - 09/30/2011**

| Year    | Total Return Gross of Fees % | Total Return Net of Fees % | *Benchmark Return % | Number of Portfolios | Dispersion % | Total Composite Assets End of Period (\$ millions) | Total Firm Assets End of Period (\$ millions) | Percentage of Firm Assets % |
|---------|------------------------------|----------------------------|---------------------|----------------------|--------------|--|---|-----------------------------|
| 2001    | 20.47                        | 19.70                      | -11.89              | 1                    | 0.00         | \$ 3.6   | \$ 1,458.2                                    | 0.25%                       |
| 2002    | -13.33                       | -14.11                     | -22.10              | 8                    | 0.17         | \$ 14.0  | \$ 1,731.0                                    | 0.81%                       |
| 2003    | 34.29                        | 33.15                      | 28.68               | 4                    | 0.86         | \$ 20.8  | \$ 2,927.0                                    | 0.71%                       |
| 2004    | 19.32                        | 18.46                      | 10.88               | 10                   | 0.46         | \$ 48.9  | \$ 3,085.8                                    | 1.58%                       |
| 2005    | 10.22                        | 9.57                       | 4.91                | 28                   | 0.29         | \$ 192.2   | \$ 3,174.4                                    | 6.05%                       |
| 2006    | 17.91                        | 17.15                      | 15.79               | 49                   | 0.30         | \$ 491.0   | \$ 3,589.4                                    | 13.68%                      |
| 2007    | 5.05                         | 4.34                       | 5.49                | 86                   | 0.48         | \$ 1,000.2   | \$ 3,960.4                                    | 25.26%                      |
| 2008    | -26.38                       | -26.91                     | -37.00              | 130                  | 0.63         | \$ 1,969.3   | \$ 4,062.5                                    | 48.48%                      |
| 2009    | 30.92                        | 30.09                      | 26.46               | 252                  | 1.22         | \$ 3,820.3   | \$ 7,008.9                                    | 54.51%                      |
| 2010    | 12.52                        | 11.81                      | 15.06               | 394                  | 0.31         | \$ 5,923.2   | \$ 9,816.0                                    | 60.34%                      |
| Q1 2011 | 5.01                         | 4.85                       | 5.92                | 436                  | 0.12         | \$ 6,717.9   | \$ 11,338.0                                   | 59.25%                      |
| Q2 2011 | 2.07                         | 1.91                       | 0.10                | 459                  | 0.11         | \$ 7,701.2   | \$ 11,819.6                                   | 65.16%                      |
| Q3 2011 | -13.91                       | -14.04                     | -13.87              | 485                  | 0.18         | \$ 6,989.5   | \$ 10,357.9                                   | 67.48%                      |

\*Benchmark: S&P 500 Index®

Effective January 2012, 2004 – 2011 gross and net composite returns were restated due to an error.

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 - 09/30/2011. 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 Large Cap Equity composite has been examined for the periods 12/31/2000 - 09/30/2011. The verification and performance examination reports are available upon request.

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 \$10.3 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 Large Cap Equity Composite was created in December 2000. These accounts primarily invest in medium to large capitalization US equities.

The FMI Large Cap Equity Composite reflects time-weighted and asset-weighted returns for all discretionary accounts. From December 31, 2000 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 standard deviation of all accounts in the composite for the entire period.

Currently, the advisory fee structure for the FMI Large Cap Equity Composite portfolios is as follows:

|                            |       |
|----------------------------|-------|
| Up to \$25,000,000         | 0.65% |
| \$25,000,001-\$50,000,000  | 0.55% |
| \$50,000,001-\$100,000,000 | 0.45% |
| \$100,000,001 and above    | 0.40% |

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 S&P 500 Index® is widely regarded as the best single gauge of the U.S. equities market. This index includes 500 leading companies in leading industries of the U.S. economy. Although the S&P 500® focuses on the large cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market. The Large Cap Equity composite uses the S&P 500 Index® as its primary index comparison.