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INVESTMENT STRATEGY OUTLOOK – SMALL CAP EQUITY

September 30, 2017

The FMI Small Cap portfolios returned approximately 4.7% and 11.4% for the three and nine months ending September 30, respectively. This compares to 5.67% and 10.94% in the corresponding periods for the Russell 2000 Index. In the quarter, sectors on the plus side for us included Producer Manufacturing, Finance and Process Industries; stocks with a positive relative impact were TriMas Corp., Woodward and ePlus. On the flip side, economic sectors Health Services, Commercial Services and Health Technology lagged, as did cash. Individual securities that hurt performance included MEDNAX, Interpublic Group and MSC Industrial.

The character and tone of most stock markets around the world remains bullish. While economic and corporate performance has improved in 2017, stocks have continued to vastly outpace fundamentals, as they have for quite some time. The average stock, and certainly almost any benchmark, appears to be significantly overvalued. Investor sentiment remains high, and while this has historically been a good contrarian indicator, it hasn't proven to be in recent years. A powerful move from active into passive investment strategies, and perhaps an unjustified but enduring belief in the Federal Reserve, may be preventing the normal ebb and flow of the market. As of this writing, it has been over 450 days since there has been even a 5% correction -- the longest stretch in over 20 years. The current 8 ½ year bull market in the S&P 500 is the second longest on record, and has gained over 340% from the trough in 2009. Most companies, particularly the types of businesses we like to own, are trading between one and three standard deviations above their long-term historical valuation ranges. The market is valued between the ninth and tenth deciles, using an exhaustive array of approximately 50 valuation measures compiled by The Leuthold Group. Valuation has become an afterthought in today's growth and momentum-driven market. This phenomenon has been in place far longer than we ever thought possible. While the confidence of the growth, momentum and passive investor (gradually all becoming one and the same) reaches a crescendo, we take comfort in the knowledge that human nature rarely changes. People who were scared stiff in 2008-09 -- and dumping stocks -- are now rolling the dice. The fear of missing out has overwhelmed value principles and risk mitigation.

A common refrain we hear is: "Stocks may be a bit elevated, but earnings are good, the Fed is a steady hand, inflation is under control, political risks are being managed, and there just doesn't seem to be anything that will derail the market." It's important to understand that this statement generally comes from four sources, all of whom have built-in biases or blind spots. First, the media perpetuates this sentiment... because a bull market is good for business. This is easy to understand when looking at the advertisements on the financial programs, and in the press. It's similar for the second constituency: brokerages and investment banks; they are not going to throw a wet blanket on a bull market, particularly when M&A (mergers and acquisitions) activity is rocking. The third source for this narrative is the money managers; they don't want investors to pull their money, so they sugarcoat reality. Finally, it's the investors themselves, who want to avoid cognitive dissonance, or the state of having inconsistent thoughts or beliefs: "I'm smart and I'm fully invested, therefore it must be the smart thing to do." When people see things the same way and act accordingly, eventually a point is reached where there aren't enough people left to convince, and the situation reverses; this is the essence of contrarian thought. Today, market participants either ignore, or don't want to entertain a narrative that conflicts with a bull market. Following is a table of items where the left side is labeled "prevailing beliefs" and the right side is "alternative beliefs." We aren't suggesting that every alternative belief will trump the more popular counterpart. It's just that in our decades of investment experience, we find that many popular beliefs end up not being true in the end; something that nearly everyone views as a pillar of faith crumbles. The prevailing belief in the 1990s was that the technology train was leaving the station and you had to be on it. In the middle of the last decade it was that home prices would never fall, and that derivative mortgage products were safe investments. No one knows which "infallible" belief will fall, but there is a good chance it will come from something on the left side of the following table.

Prevailing beliefs	Alternative beliefs
The economy is sound and is getting better.	The economy has chronically underperformed, and is trapped in a low-growth mode, despite massive fiscal stimulus. Organic growth stimulants are still missing.
Stocks will continue to rise because interest rates will remain low.	Stocks have already risen at approximately double their normal rate for 8 ½ years, partly due to low interest rates. Eventually, risk will be reflected in the price of money.
Inflation will not be a problem.	Services, over double the weighting of goods in the economy, have inflated 2.4-3.2% in recent years. Governments almost always engineer inflation to ease debt repayment.
Valuations are reasonable.	Valuations are extremely high. The median stock is significantly higher-valued than in the peak of 1999-2000.
The Federal Reserve has managed through tough times, and has “investor’s backs,” so to speak.	The Fed has crushed savers, and caused a massive misallocation of resources. Inflating assets to spur wealth-effect spending hasn’t worked in nearly nine years.
Quantitative Easing (QE) has worked well and can be unwound gracefully.	If QE was good for stocks, how can the unwinding of the Fed’s balance sheet also be good?
Passive indexing is an economical and low-risk investment approach.	Indexing has become a momentum trade. Herd behavior never ends well. What a smart person does in the beginning, a fool does in the end.
FAANG stocks (Facebook, Apple, Amazon, Netflix, and Alphabet’s Google), tech, and biotech are unique opportunities that shouldn’t be measured by traditional valuation metrics.	Almost all stocks have their reckoning at some point, and eventually trade within a justifiable bound of conventional valuation.
Budget deficits matter little.	Increased government debt robs private sector investment and crimps growth. It burdens future generations. World debt levels are increasing, and exceed those of 2007.
The unemployment rate is low, which is a sign of health.	Tens of millions of people have dropped out of the workforce, skewing the unemployment rate measure. The total number of full-time workers is just 5 million higher than it was 10 ½ years ago.
Low volatility is a sign of negligible risk.	Abnormally low volatility indicates a dangerous level of complacency.
Investor confidence is high, indicating good times for the economy and the stock market.	For most of history, high confidence was a precursor for low future returns; it is a contrary indicator.
Wall Street earnings are growing nicely.	Most companies now use adjusted earnings, which ignore full costs. Adjusted earnings per share vs. GAAP (generally accepted accounting principles) earnings exceeds 30%. True underlying earnings growth doesn’t vary much from nominal GDP over the long run.
Politicians and poisonous political differences won’t halt stocks or the economy.	Anything is possible out of Washington; the environment is unusually volatile. Political dysfunction hasn’t hurt yet, but if investors become sour, it will weigh on multiples.
Geopolitical risks, i.e., North Korea, Iran, Russia, China and Latin America, won’t derail stocks.	Any one of these could break the wrong way. The Chinese credit bubble is particularly risky.
Demographics are not a concern.	Rich countries are not replacing their populations. Retirement benefits and budgets are imperiled by upside-down demographics.

Prevailing beliefs	Alternative beliefs
Housing and autos are healthy. Lending is healthy.	Four of the past five months, mortgage applications have fallen. Autos appear to be rolling over. Credit growth metrics are falling.
Companies will buy back shares to keep earnings per share growing.	Buying back shares does little for the economy. Doing it with borrowed money at extreme valuations is a low-return, high-risk endeavor.
Crypto currencies like Bitcoin will revolutionize money and payment systems.	The dramatic rise in these currencies smacks of rank speculation. Only in a runaway bull market could you see anything like this.
The S&P 500 is at an all-time high, which indicates strength, and is also a low-risk way to invest.	The market is narrow, and is unnaturally benefitting from indexing. Any asset class, including an index fund, can become overvalued.
M&A is a positive, as it boosts growth rates.	Many studies show that on balance, M&A destroys value for the acquiring entity. Managements and analysts want people to ignore recurring write-offs and poor returns on invested capital. Today deal valuations are extreme.
There is a pile of cash on the sidelines poised to enter the market.	Money market funds have been in a range of approximately \$2.6-2.8 trillion since 2010. Overseas cash faces heavy taxes.

In a study done ten years ago, two Stanford researchers, Peter DeMarzo and Ilan Kremer, along with Ron Kaniel of Duke University, showed that “what investors fear the most is not the risk of loss per se, but the risk that they may do poorly relative to their peers.” The study revealed that investors knowingly bought risky securities and tended to “choose portfolios that look a lot like others in their community or professional cohorts.” DeMarzo said, “Such herding around certain investments allows you to combat the fear that everyone else might be betting on the winner and you’re not.” It is difficult to try to convince people to fight their impulses, because investors seem to be inherently programmed to follow the hot hand -- either that, or they throw up their hands and index (“If I can’t beat them, I’ll join them”). Investors simply cannot fathom that both strategies are fraught with risk today. The hot hand is likely to be trafficking in risky growth stocks, and indexing suffers from a nonfundamental buy/sell algorithm (money flow) that today is buying despite extreme valuations.

Yes, we are going to have a bear market; all bull markets are followed by the opposite and it will probably unfold when sentiment is high and the outlook, at least from the CNBC pundits, is positive. One can avoid losses by going to cash. Going to all cash is not an easy strategy as it implies having to make a second decision to return to the market. Over the decades, our observation is that many who make the decision to go to cash usually do so after getting clobbered, and if they do return, it is typically well after the next bull market is underway. Thus, it is rarely successful. Still, in theory, if you could stomach listening to your friends talk about how much money (on paper) they were making in the most popular stocks or index funds, and you had the mettle to redeploy into equities when the markets were in disarray, you might not find a better time than today to do it.

Practically speaking, however, it is usually better to just ride out bear markets if one truly has a long-term investment time horizon. The question then becomes, “What kind of investment approach is best suited to take one through the inevitable down market and up the other side?” We will begin our self-serving answer with a statement that historically we have generally outperformed in difficult markets, and this has overwhelmed the underperformance in bull markets such that full cycle performance is superior. The peak of the current 8 ½ year bull market is unknowable, so this cycle could be different, but it really doesn’t change the basic premise. We own strong business franchises that trade at significant discounts to the benchmark, and at a very wide discount to the growth stocks driving the bull market. Our companies are likely to earn a return in excess of their cost of capital over

a cycle, and they have solid balance sheets. We also have a deep list of stocks in our bullpen into which we can move aggressively when volatility emerges. We have the constitution to make difficult swaps amid a bear market (selling a stock that holds up relatively well, and redeploying the proceeds into a stock that has been unfairly punished, and that has significantly higher upside). Conversely, investors can choose to stick with the recent big winners and hope that they do not turn out like the 1990s vintage, many of which today still trade at fractions of their former value, or are no longer in business. Investors can opt to hang on to their index funds, which appear extraordinarily overvalued, much as they did in the late 1990s to early 2000s. The price of the S&P 500 in March of 2013 was 1,527 -- the same price it was thirteen years earlier, the last time the S&P 500 was as inflated as it is now. Even though nearly everyone is making money, today's investment landscape is by far the most difficult we have experienced, in terms of finding solid businesses at reasonable prices. We are, however, confident in our team and in the belief that over the long term, we will produce superior risk-adjusted results.

As is customary in the September letter, we highlight a couple of investments:

Penske Automotive Group, Inc. (PAG)

(Analyst: Andy Ramer)

Description

Penske Automotive is an international transportation services company. Retail Automotive is the largest contributor to the business, at 94% of revenues and 80% of pretax earnings. Premium luxury brands account for 70% of auto dealership revenue. Markets outside of North America account for 42% of sales, with the U.K. accounting for 80% of this portion. New vehicles account for 48% of revenue, but only 25% of gross profit. Parts & Service, used vehicles, financing, and insurance make up approximately 75% of gross profit.

Good Business

- Dealers represent a critical component of the automotive value chain. The increasing complexity of new vehicles, and stepped up requirements from automakers to strengthen corporate identity, should help capably-advantaged, publicly-traded dealers like Penske continue to gain market share.
- Vehicles are big ticket items that are inherently more cyclical, but many consumers consider them to be a necessity – they need to get to work. The Parts & Service business, which, including commercial trucks, accounts for over 40% of total company gross profit, is more recurring in nature, and dependent upon the number of vehicles in operation rather than unit sales.
- Penske generates a return on invested capital that has equaled or exceeded its cost of capital over a business cycle, and should continue to do so.
- This is an easy business to understand.
- The debt-to-capital ratio of 50% is within the targeted range. The business generates good free cash flow.

Valuation

- The stock's typical price-to-earnings multiple premium relative to the peer group has evaporated, and now trades at a discount.
- On an enterprise value-to-sales basis, the stock is valued in line with what Berkshire Hathaway paid to acquire the largest privately-held auto dealer group in the country.
- Shares trade for approximately 12.5 times 6-year average earnings before interest and taxes (EBIT) and 9.5 times forecast 2017 EBIT.
- The Parts & Service business alone contributes more than \$1.50 per share in earnings. At a 15-16 multiple, a business that accounts for just over 10% of sales would represent more than one half of the market capitalization.

Management

- Penske Automotive is run and controlled by one of the auto industry's most successful entrepreneurs – Chairman & Chief Executive Officer Roger Penske. He owns 40% of the company, or around \$1.5 billion of stock.
- Robert Kurnick, Jr. has served as President since April 2008, and has been a director since May 2006. J.D. Carlson has been Chief Financial Officer since June 2015.
- The company returns capital to shareholders in the form of a \$0.32 quarterly dividend, or the equivalent of a nearly 3.0% yield, on an annualized basis.

Investment Thesis

With the stock price down by 20% from its 52-week high, shares have begun to discount concerns that the automotive market has peaked, and are thus reasonably valued on a relative basis. Penske Auto is positioned to gain share, both organically and via acquisitions, and earnings should benefit from the resiliency provided by the Parts & Service business. We continue to monitor the growth of electric and autonomous vehicles and the ramifications of this over the near and long term.

TriMas Corporation (TRS) (Analyst: Matt Sullivan)

Description

TriMas is a global designer, manufacturer and distributor of engineered products for commercial, industrial and consumer markets. The company operates in four business segments: Packaging (43% of sales, and 70% of profits), Aerospace (23%, and 15%), Energy (19%, and 4%), and Engineered Components (15%, and 11%). The Packaging business makes specialty closures and dispensers for consumer and industrial products that are sold to a variety of end markets. The Aerospace business is a leading supplier of highly-engineered fasteners to the aerospace industry. The Energy business manufactures gaskets, bolts, industrial fasteners and specialty products for the petroleum refining, petrochemical, oil field and industrial markets. The Engineered Components business manufactures steel cylinders used for compressed gas transportation, storage, and dispensing, as well as a variety of gas powered engines and parts sold for use in oil and natural gas production. The company was founded in 1986 and is headquartered in Bloomfield Hills, Michigan.

Good Business

- We estimate that TriMas' return on invested capital (ROIC) is approximately 12%, which exceeds the company's cost of capital.
- TriMas' offerings typically constitute a small portion of a customer's total production costs, but are critically important to the end product.
- The company's businesses have relatively high barriers to entry. Each business segment exhibits one or more of the following characteristics: the products are, 1) highly engineered, 2) patent protected, 3) sold into industries with stringent regulatory requirements, 4) sold under long-term contracts, 5) have well established and highly regarded brands, and/or 6) the businesses have long-standing relationships with customers.
- The Packaging and Aerospace businesses, which together contribute the vast majority of the company's earnings, should drive growth going forward, because of their high barriers to entry.
- The Packaging and Aerospace businesses are defensive. The Packaging business' dispensers and closures are mainly used in consumer non-durable products. The Aerospace business sells its products to customers that have large order backlogs and long-term contracts with a limited number of suppliers.
- The company has a strong balance sheet, and the businesses are easy to understand.

Valuation

- The stock trades at 17.5 times our next 12-month earnings per share estimate, which is a significant discount to the Russell 2000, as well as other comparable companies serving similar end markets.
- On a sum-of-the-parts basis, the stock trades at a discount to our fair value estimate.

Management

- Tom Amato became President and Chief Executive Officer of TriMas in July 2016. He has more than 25 years of broad industrial experience, having served in several leadership positions at global, multi-billion dollar businesses. He's also worked as a CEO for companies owned by notable private equity firms, including The Carlyle Group and American Securities.
- Bob Zalupski joined TriMas in 2002 and has more than 30 years of business and financial management experience. Prior to being named Chief Financial Officer in 2015, Bob was Vice President of Finance and Corporate Development, and Treasurer.

Investment Thesis

TriMas is a collection of above-average businesses. The Packaging and Aerospace segments are the company's best businesses and contribute the vast majority of earnings, and are relatively defensive with solid long-term growth and ROIC prospects. Over the past few years, however, the fundamentals of the smaller, less important business segments, which have exposure to oil and gas end markets, have underperformed. Additionally, the Aerospace business has been going through a difficult integration of a large acquisition made by a previous management team. These temporary setbacks have overshadowed the company's attractive business qualities and solid long-term prospects, and caused the stock to lag. As management works through these issues, we expect the market to ascribe a higher multiple to TriMas' growing earnings stream.

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		Total Composite Assets End of Period (\$ millions)	Total Firm Assets End of Period (\$ millions)	Percentage of Firm Assets %
						Composite	*Benchmark			
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.