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INVESTMENT STRATEGY OUTLOOK – INTERNATIONAL EQUITY

September 30, 2020

Being a value investor in a growth and momentum-driven stock market is a lonely existence, but one that can be quite rewarding through a full cycle. As Warren Buffett once said, it is wise to "be fearful when others are greedy, and greedy when others are fearful." Today, we are seeing an abundance of greed, notwithstanding a few pockets of fear (hint: international value equities). We have continued to remain true to our research process and value orientation despite the challenging backdrop.

In the third quarter, the FMI International portfolios continued to rebound, advancing approximately 4.7% (currency hedged) and 6.9% (currency unhedged), which compares with an MSCI EAFE Index gain of 1.22% in local currency (LOC) and 4.80% in U.S. Dollars (USD). Unfortunately, value stocks have continued to fall out of favor, as the MSCI EAFE Value Index declined 2.34% in LOC and gained 1.19% in USD in the period, each lagging their comparable MSCI EAFE Growth Index by over 7%. Performance in the portfolios was led by Ferguson PLC, B&M European Value Retail S.A., and Hyundai Motor Co. Preferred, as Amorepacific Corp. Preferred, Chubb Ltd., and Jardine Strategic Holdings Ltd. each detracted. The Consumer Services, Distribution Services, and Consumer Durables sectors were positive contributors, while Producer Manufacturing, Technology Services, and Industrial Services lagged. A weak USD hurt FMI's currency hedged performance.

In 2020, the portfolios have been especially hard-hit by COVID-related headwinds. We look forward to a rebound in several companies where we believe the long-term prospects are far more attractive than they are currently being given credit for. We think we have a number of "coiled springs" in the portfolio, poised to outperform once business starts to normalize. If, for example, our holdings were simply to return to their 52-week highs, the portfolios would be up over 27%, and in our opinion, *still* be undervalued.

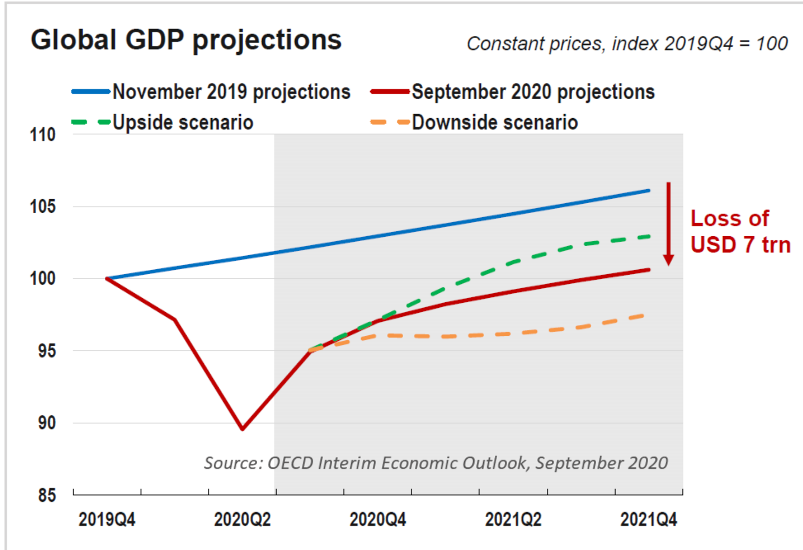
Given the litany of risks investors should be trying to carefully navigate (global pandemic, deep recession, elevated valuations, central bank profligacy, leverage, geopolitical risks, and inflation, to name just a few), there is no better time to own a collection of high-quality companies. Our portfolios are filled with what we feel are durable, competitively advantaged businesses with strong balance sheets and skilled management teams. Not only do these companies have the wherewithal to make it through these tough times, but most should come out even stronger on the other side. The portfolios trade at a significant discount to our benchmarks, which should bode well for future returns.

Everything but the Kitchen Sink

To prop up the global economy, policymakers have responded with unprecedented force, throwing anything and everything at the problem. Collectively, global central banks and governments have tallied *$21 trillion* in monetary and fiscal stimulus, a truly remarkable sum (~24% of 2019 GDP).[1] At the same time, world debt has soared to a record high 331% of GDP ($258 trillion).[2] While economic growth has come in a bit better than originally feared (with Organisation for Economic Co-operation and Development [OECD] estimates for 2020 global Real GDP growth of -4.5% in September versus -6.0% in June), the recovery is starting to lose some steam, and growth is now expected to be $7 trillion lower than pre-COVID estimates for 2021 (see the following chart).[3] Following a period of

[1] Michael Hartnett, David Jones, and Shirley Wu. "The Thundering Word: The Hitchhiker's Guide to the Investment Universe." *BofA Global Research*, September 3, 2020.
[2] Emre Tiftik, Khadija Mahmood, and Sonja Gibbs. "Global Debt Monitor." *Institute of International Finance*. July 16, 2020.
[3] Laurence Boone. "OECD Interim Economic Outlook: Living with Uncertainty." September 16, 2020

widespread lockdowns, the early gains are starting to moderate, with a recent surge in COVID-19 cases dampening the reopening process. Growth may slow further as employment subsidy programs wind down and layoffs ensue. While we are hopeful that rapid antigen testing and vaccines will be important steps toward returning to more "normal" levels of business activity, it is unclear how quickly these will be approved and made available to the masses. We expect to see some permanent changes in human behavior as a result of the pandemic, but the magnitude remains unclear. We are living through times for which there is no real historical precedent.



Despite tremendous economic uncertainty, speculation continues to run rampant in financial asset markets. Unfortunately, normal price discovery has been all but lost, as massive asset purchasing programs (quantitative easing) have continued to distort the market's pricing mechanisms. Interest rates are artificially low, which has inflated asset prices and valuations, especially on the more speculative end of the risk spectrum, i.e., long-duration growth stocks. Low or negative-yielding debt is pushing investors into riskier assets in search for yield and returns.

Consider your UK retiree who has GBP 1.5 million in savings, for example. In the decade leading up to the great financial crisis, they would have been able to generate at least a 5% yield on a 10-year UK government bond, netting GBP 75,000 of interest income. Today, with a 10-year yield of 0.23%, one would need almost *$33 million* in savings to generate the same GBP 75,000. To generate a 5% return, the retiree would likely have to venture out into junk bonds or equities, where the risk profile is far greater. According to the *Financial Times*, "Just 3 percent of the investable bond world today yields more than 5 percent — a share that is close to an all-time low and represents a precipitous drop from levels seen roughly two decades ago. In the late 1990s, nearly 75 percent of bonds traded with yields above 5 percent, while sub-2 percent yields comprised well under 10 percent of the market [vs. 86% today]."[4] To describe today's interest rate environment as extraordinary would be a massive understatement.

To that point, $15+ trillion of negative-yielding bonds globally is extremely worrisome, as the mere thought of investors buying Greek or Italian bonds trading at a guaranteed loss (if held to maturity), defies logic. In our view, central banks have gone too far, too fast, and will find themselves in a very difficult situation in the years to come. The Bank of Japan has been so aggressive printing money and gobbling up assets that it could soon own around 50% of Japanese government bonds, 50% of the country's commercial paper, one-sixth of corporate bonds,[5] and 75% of its exchange-traded funds (ETFs).[6] Meanwhile, *The Wall Street Journal* reports that "The European Central Bank is vacuuming up sovereign bonds faster than governments can pump them out," and that "UBS expects the net supply of European government bonds to be minus €73 billion in 2020 […] compared with €182 billion last year. This means that the central bank is projected to buy more bonds this year than governments sell, after factoring

[4] Colby Smith. "Hard times yield-squeezed bond investors follow the path into 'extreme risk' territory." *Financial Times*, July 26, 2020.
[5] Leo Lewis. "Bank of Japan to tighten grip on corporate bond market." *Financial Times*, April 27, 2020.
[6] Min Jeong Lee and Toshiro Hasegawa. "When Will BOJ Slow ETF Buying? Some Say When Nikkei Tops 20,000." *Bloomberg*, April 6, 2020.

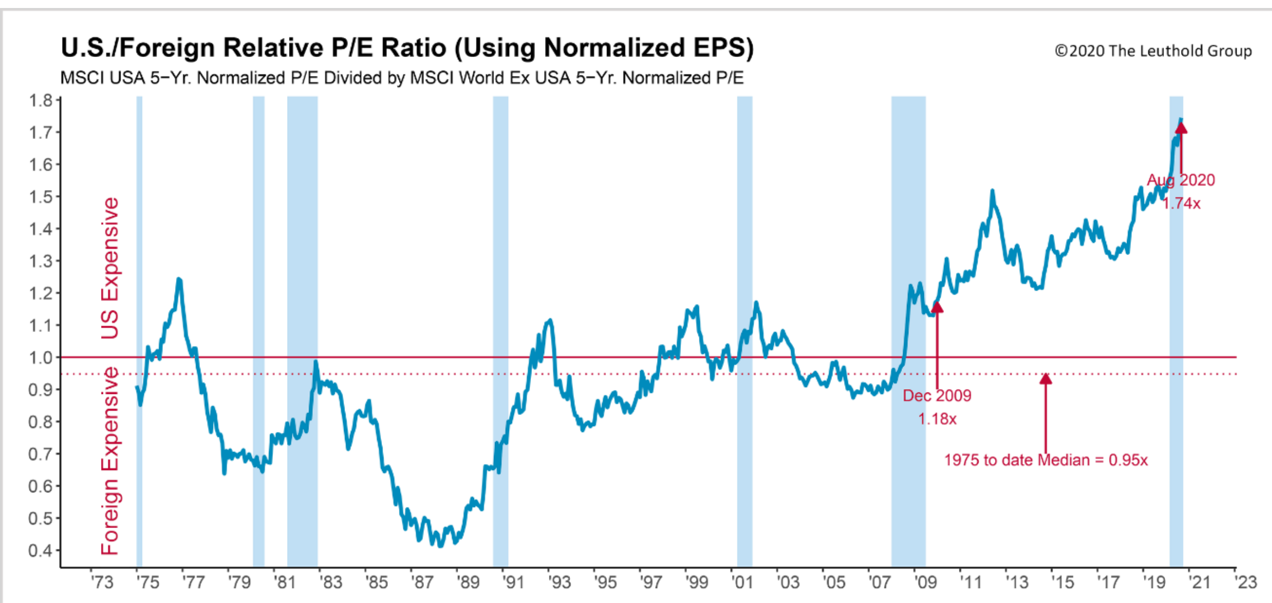
out bonds that are repaid."[7] With price-insensitive buyers of this scale moving markets, it's no wonder asset prices have become disconnected from the fundamentals. Printing money may be the oldest trick in the book, but there is no historical precedent where it has *actually worked*.

Relative Value Overseas

Thinking about Warren Buffett's message about greed and fear in the context of the global investment landscape is informative. In looking at equity performance over the past ten years, we have seen a remarkable divergence between U.S. and international stock markets. Over the last decade, the Standard & Poor's 500 Index generated a return of 262.44% (13.74% per annum), trouncing the MSCI EAFE Index gain of 83.50% (6.26%) in LOC and 57.06% (4.62%) in USD.

Not surprisingly, the U.S. stock market is littered with signs of excess, as we have outlined in our Large and Small Cap letters. The geographic bifurcation recently became so extreme that the market cap for U.S. tech stocks exceeded that of the entire European stock market (which had been *four times larger* than U.S. tech back in 2007).[8] The market cap for the top four tech names (Apple, Amazon, Microsoft and Alphabet) was greater than the Japanese stock market in total – as well as the combined China and Hong Kong stock markets! Apple's market cap alone exceeded the size of the FTSE 100 Index, a basket of the largest companies in the UK.[9] Ironically, Apple's operating profits are expected to be lower in 2020 than they were in 2015. And yet, somehow the stock has gained 354.54% over the past five years, going from a market cap of $629 billion to $1.98 trillion. Today, it trades for 35 times trailing price-to-earnings (versus a 10-year average of 16 times), despite underwhelming growth prospects. The greed alarm bell doth toll, and loudly!

As the following chart illustrates, the valuation premium for U.S. versus foreign stocks (in developed markets) is at the highest level it has been in over 40 years, and by a significant margin.

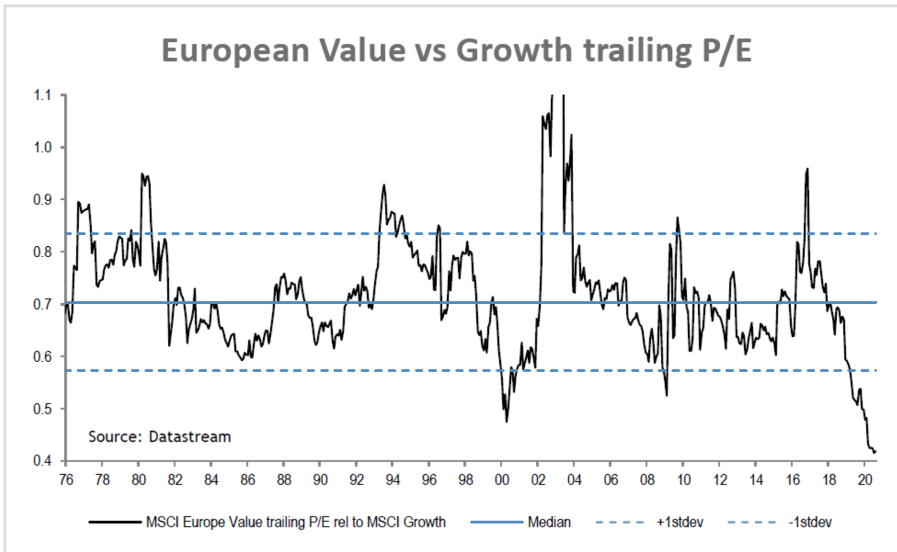


[7] Anna Hirtenstein. "European Central Bank Smothers Government Bond Market." *The Wall Street Journal*, September 11, 2020.
[8] Jesse Pound. "U.S. tech stocks are now worth more than the entire European stock market." *CNBC*, August 28, 2020.
[9] Daren Fonda. "4 Big Tech Companies Are Larger Than Japan's Stock Market. Why Investors Should Be Cautious." *Barron's,* August 28, 2020.

While sector mix tells some of the story, with more tech exposure in the U.S. and financial exposure in Europe, even on a sector-neutral basis the price-to-earnings premium is well above historical averages.[10] As we look out across the globe, we see attractive opportunities in international markets (a couple of which we highlight at the end of this letter), with better absolute values than are currently available in most of the U.S. Given the valuation disparity, we expect to see strong relative performance in foreign markets in the years ahead.

<u>The Tide Will Turn</u>
Growth investing has benefited from low interest rates (see our discussion in the June letter), a shift from active to passive investing (fueling momentum strategies), and economic fragility (sectors and industries that were most impacted by COVID-19 have been in the value camp), among other factors. Predictably, investors are chasing recent performance and buying what has been working, regardless of the valuations. As in every other market cycle, speculation will be generously rewarded… until it isn't.

Over the past decade, the MSCI EAFE Growth Index (USD) has gained 96.75% (7.00% per annum), over four times the 23.07% (2.10% per annum) return of the MSCI EAFE Value Index (USD). At some point investors will wake up to the reality that value stocks have been vastly oversold and growth stocks bid too high. Eventually, mean reversion will kick in and run its course. In Europe, value stocks trade at a record discount to growth of nearly 60% (see chart to the right),[11] so those that lean into the wind will be doing so with what appears to be a sizeable margin of safety.



While it has been a trying time for value investors, with history as our guide we are confident that better days lie ahead. Eventually the global economy will recover, rates will normalize, and fundamentals and valuation will start to re-enter the conversation. In the meantime, we will keep our heads down, trying to find the next compelling value in an overvalued world. Below are a couple of stocks we believe fit the bill.

Jardine Strategic Holdings Ltd. (JS SP)
(Analyst: Dain Tofson)

<u>Description</u>
Jardine Strategic is a family-controlled investment holding company with a focus on Greater China and Southeast Asia. Key holdings include controlling positions in Dairy Farm, Hongkong Land, Jardine Cycle & Carriage, Mandarin Oriental, and a cross holding in Jardine Matheson. Key industry exposures include retail store operations (grocery, convenience store, drug store, home furnishings), real estate investment and development, automobile dealerships, luxury hotel management, restaurant management, manufacturing and financing activities, mining,

[10] Mislav Matejka, Prabhav Bhadani, and Nitya Saldanha. "Global Equity Strategy." Page 86. *J.P. Morgan Cazenove*. September 1, 2020.
[11] Ibid, 144.

agribusiness, and engineering and construction, among others. In 2019, underlying profits were split 54% Greater China, 44% Southeast Asia, and 2% Rest of World. Mainland China specifically contributed 20% of underlying profits.

Good Business

- The key holdings generate a return in excess of cost of capital over an economic cycle.
- The company's competitive advantage lies in its very deep knowledge base of Greater China and Southeast Asia and long-standing contacts and relationships in the countries in which it operates.
- Jardine Strategic's holdings include several businesses with local incumbent advantages and market share positions that would be very difficult and costly to replicate.
- The company generates various sources of recurring revenue including rent on commercial buildings (Hongkong Land), automobile service and components (Jardine Cycle & Carriage through its controlling interest in Astra), and purchase of consumer staples (Dairy Farm).
- As of 1Q 2020, Jardine Strategic Corporate had a net cash balance of $2.3 billion. Consolidated net debt excluding financial services companies as a percentage of equity was 10%.

Valuation

- The company trades at 8.0 times 2021 earnings per share versus a 10-year average of 11.3 times.
- The shares also trade at a price-to-book ratio of 0.3 times, close to an all-time low.
- Jardine Strategic is trading around a 50% discount to NAV based on the public market value of its listed holdings, versus a historical average discount of 35%.
- The key holdings are inexpensive on a standalone basis – Hongkong Land trades at 8.4 times 2021 earnings per share or 0.2 times price-to-book; and Jardine Cycle & Carriage trades at 7.8 times 2021 earnings per share; Dairy Farm trades at 17.0 times 2021 earnings per share – and, if you apply Jardine Strategic's NAV discount, our implied earnings per share multiple on the key holdings is roughly half of the standalone multiple.

Management

- The family has successfully navigated Southeast Asia and Greater China for over 180 years and has a proven track record of creating shareholder value (20-year outperformance vs. the MSCI EAFE Index.)
- Management takes a long-term view and is known for being contrarian. As an example, they invested in Astra in 2000 after the Asian Financial Crisis when others were still skittish.

Investment Thesis

Jardine Strategic has an impressive long-term track record in part due to its very deep knowledge base of the Greater China and Southeast Asia region, and long-standing contacts and relationships in the countries in which it operates. As such, Jardine Strategic allows us to participate in a region that we might otherwise struggle to navigate. The stock trades at a very low 8.0 times 2021 earnings per share, and at a sizeable discount to its NAV. The valuation offers a large margin of safety. At the same time, the $2.3 billion of net cash gives management a lot of firepower to capitalize on opportunities that arise during the COVID-19 downturn.

Chubb Ltd. (CB)

(Analyst: Ben Karek)

Description

Chubb is one of the largest publicly traded property and casualty (P&C) insurance companies globally. In aggregate, the company has operations in 54 countries and territories. Chubb provides commercial, personal property, casualty, personal accident, and supplemental health insurance to a diverse group of clients. Approximately 63% of premiums are from the U.S., 13% from Europe/Eurasia and Africa, 11% from Asia, 7% from Latin America, and 6% from Bermuda and Canada. By product, the mix is Commercial P&C 55%, Personal Lines 21%, Accident & Health/Life

17%, Agriculture 5%, and Reinsurance 2%. The Chubb brand is probably best known as the leading provider of insurance to high net worth individuals.

Good Business

- Chubb is a durable, differentiated multi-line insurer with an attractive small and middle market commercial book of business, as well as a respected high net worth personal lines customer base.
- For medium to larger-sized commercial enterprises, casualty insurance is a necessity coverage. This non-discretionary attribute, along with Chubb's emphasis on high service levels, results in strong customer retention and predictable revenues. The company's renewal retention ratio generally ranges between 85 to 90% (it was 95% in 2019 for major accounts).
- Chubb's disciplined risk selection and cycle management has led to conservative initial loss picks, underwriting stability, and a consistent return on equity (ROE).
- Over the past ten years the company's underwriting combined ratio is 7.6% better than the industry.
- Operating expenses are over 4% lower than large cap peers.
- The company presently generates a 14% return on tangible equity. Incremental returns on invested capital are attractive.
- Chubb currently maintains industry-low balance sheet leverage metrics across the three most important indicators of net premiums to shareholder's equity (0.6 times), invested assets to shareholder's equity (2.0 times), and debt-to-total capital (22%). The company's investment portfolio is purposefully "plain vanilla."
- The investment portfolio duration is four years with an average credit quality of A/Aa.

Valuation

- Over the past 25 years, Chubb's price-to-book multiple has averaged close to 1.5 times, ranging from a low of one times to a high of over two times, and it currently trades below book value. At 1.5 times book value per share, the stock would be valued at $182 per share.
- Over the past ten years, Chubb has grown book value per share at a 6% compound annual growth rate. The dividend yield is 2.7%.

Management

- Chubb has a diverse and highly respected management team led by Chairman and CEO Evan Greenberg, who personally owns $122 million in stock.
- Management is compensated based upon key financial metrics (75% overall weight) of tangible book value per share growth, core operating ROE, core operating income, and the P&C combined ratio. The residual quarter of incentive compensation is determined by operational and strategic goals.
- Mr. Greenberg's management team has been a cohesive group with backgrounds tying back to legacy ACE Limited and supplemented by key individuals staying on from the legacy Chubb organization.
- Philip Bancroft has been the CFO of Chubb Limited since January 2002.

Investment Thesis

Chubb is one of the largest P&C insurers globally and has a specialty in high net worth personal lines. Chubb has industry-leading combined ratios and is led by one of the best insurance CEOs in the industry. The company is benefitting from the industry underpricing risks the last few years, which has led to firming pricing without the reserve charges taken by many of its peers. This has driven the best premium growth in many years. With regard to COVID specifically, there is talk about regulators or governments forcing insurance companies to pay business interruption claims even though the policies specifically exclude viruses and pandemics. There is no court ruling or other precedent for this complete disregard for contract law, and we view the probability that this intervention holds up in court as very low.

Thank you for your confidence in Fiduciary Management, Inc.

Fiduciary Management Inc.
International Equity Composite
12/31/2010 - 12/31/2019

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			
2011	-0.78	-1.52	-12.15	1	0.00	n/a	n/a	$ 16.7	$ 12,273.6	0.14%
2012	19.35	18.46	17.31	1	0.00	n/a	n/a	$ 76.3	$ 15,253.5	0.50%
2013	25.89	24.95	26.93	1	0.00	9.78	12.22	$ 165.8	$ 19,705.3	0.84%
2014	5.66	4.87	5.92	1	0.00	7.49	10.33	$ 771.6	$ 21,001.1	3.67%
2015	4.24	3.46	5.33	2	0.00	8.14	11.73	$ 2,832.9	$ 21,042.9	13.46%
2016	11.04	10.23	5.34	3	0.38	7.39	11.53	$ 5,946.2	$ 22,626.7	26.28%
2017	16.51	15.70	15.23	3	0.02	7.04	11.20	$ 8,209.3	$ 25,322.0	32.42%
2018	-8.63	-9.27	-10.99	3	0.06	7.22	9.69	$ 6,287.8	$ 19,833.6	31.70%
2019	18.11	17.29	21.67	3	0.08	8.30	9.48	$ 7,522.0	$ 22,609.8	33.27%

*MSCI EAFE Net Local 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, Incorporated (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 International Equity Composite has been examined for the periods 12/31/2010-12/31/2019. 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 $22.6 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 International Equity Composite was created on December 31, 2010. This composite invests mainly in a limited number (usually between 25-40) of large capitalization (namely, companies with more than $5 billion market capitalization) foreign companies.

The International Equity Composite reflects time-weighted and asset-weighted returns for all discretionary accounts. 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®. For the periods 2011-2012, the information is not available for the International Equity Composite.

Currently, the advisory fee structure for the International Equity Composite portfolios is as follows:

Up to $25,000,000	0.70%
$25,000,001-$50,000,000	0.65%
$50,000,001-$100,000,000	0.60%
$100,000,001 and above	0.55%

The firm generally requires a minimum of $25 million in assets to establish a discretionary account. 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 MSCI EAFE Net Local Index® is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI EAFE Net Local 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. It is reported in local currency and net of hedges. The International Equity composite uses the MSCI EAFE Net Local Index® as its primary index comparison.

Fiduciary Management Inc.
International Equity Unhedged Composite
12/31/2019 - 09/30/2020

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 %
Q1 2020	-29.09	-29.22	-20.55	1	0.00	n/a	n/a	$ 26.5	$ 15,121.8	0.17%
Q2 2020	14.54	14.32	12.60	1	0.00	n/a	n/a	$ 31.7	$ 15,293.9	0.21%
Q3 2020	6.86	6.66	1.22	1	0.00	n/a	n/a	$ 47.5	$ 14,993.2	0.32%

*MSCI EAFE Net Index (USD)®

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