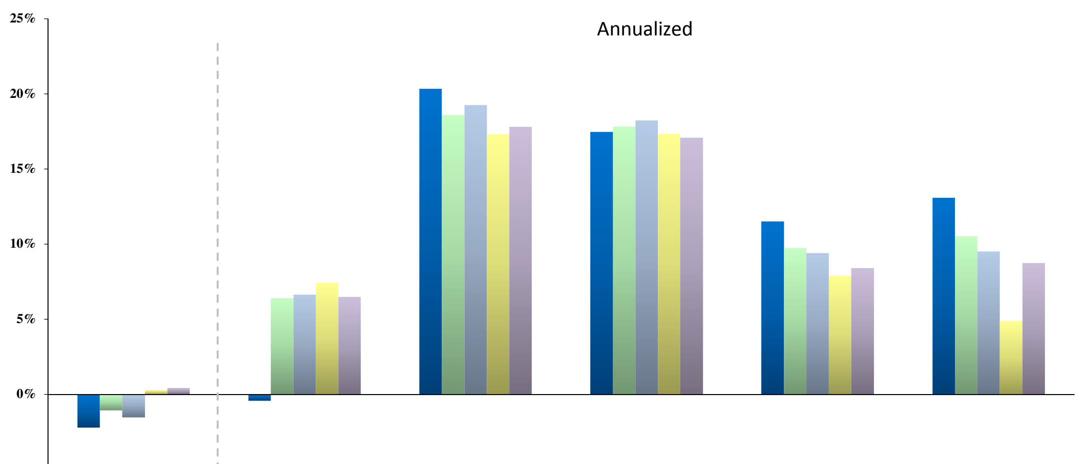
# FAIRPOINTE MID-CAP CORE

2ND QUARTER COMMENTARY 2015

The Fairpointe Mid-Cap Composite was down 2.2% in the second quarter, underperforming the benchmark returns for the Russell MidCap, down 1.5%; the S&P 400, down 1.1%; and S&P 500, up 0.3%.




| | 2nd Qtr 2015 | 1 Year | 3 Years | 5 Years | 10 Years | Since Inception ** |
|---|---|---|---|---|---|---|
| Fairpointe Mid-Cap * | -2.22% | -0.42% | 20.34% | 17.47% | 11.50% | 13.08% |
| S&P 400 MidCap Index | -1.06% | 6.40% | 18.60% | 17.82% | 9.74% | 10.53% |
| Russell MidCap Index | -1.54% | 6.63% | 19.26% | 18.23% | 9.40% | 9.50% |
| S&P 500 Index | 0.28% | 7.42% | 17.31% | 17.34% | 7.89% | 4.90% |
| Russell 2000 Small Cap Index | 0.42% | 6.49% | 17.81% | 17.08% | 8.40% | 8.75% |

* Net of Fees ** Performance represented from April 1, 1999

## Second Quarter Review

Performance was negatively skewed with 14 stocks down more than 10% compared with eight stocks up more than 10%. The top performing stocks (in order of contribution[1] to portfolio return) were: AGCO Corporation (AGCO), up 19.5%; Nuance Communications (NUAN), up 22.0%; McDermott International (MDR), up 39.1%; Juniper Networks (JNPR), up 15.4%; and Mattel, Inc. (MAT), up 14.1%.

**AGCO** is a leading producer of agricultural equipment. The farming industry is currently in the midst of a cyclical downturn due to lower crop prices and farmers delaying purchases of new equipment. AGCO has executed well in this challenging environment through cost cutting and product innovation. We believe the company is well positioned to significantly increase earnings once agricultural spending improves.

**Nuance** is a leading provider of voice recognition software for medical, mobile, consumer and corporate customers. The company has been transitioning its revenue recognition model from one-time sales to recurring subscription contracts. The transition is nearly complete and should lead to more predictable results in the future. We believe the company's valuation remains attractive and will benefit from more consistent revenue growth.

[1]Performance contribution represents stock weighting, transactions, dividend and price movement.

**McDermott** provides engineering and construction work for offshore oil and gas projects. A new CEO was hired in 2013 after a number of projects experienced execution issues. The new CEO is addressing these issues, building the management team and changing the company's culture. Current low energy prices have slowed and deferred many exploration and production projects but the company continues to make progress toward profitable growth. McDermott has strong relationships with many national oil companies, such as Saudi Aramco, which we view as a competitive advantage. Our recent meeting with the CEO reinforced our positive view of the company. We added to our position based on the positive long-term outlook.

The largest detractors to performance were: Cree, Inc. (CREE), down 26.7%; Teradata Corp. (TDC), down 16.2%; United States Steel Corp. (X), down 15.3%; Copa Holdings SA (CPA), down 16.6%; and Gerdau SA (GGB), down 24.4%.

**Cree** is a leading producer of energy efficient LED (light-emitting diode) semiconductors, bulbs and lighting. While the company missed earnings expectations in the most recent quarter, the long-term thesis has not changed. LED lighting lasts 25 times longer than conventional lighting and is 85% more efficient. Cree holds over 940 U.S. patents, has a strong balance sheet with $5.66 of net cash per share and trades at book value. We believe Cree's stock is attractively valued and we have added to our position.

**Teradata** is a global technology leader in database analytics. The company missed earnings expectations in its most recent quarter due to sales delays and adverse foreign exchange movements. However, the long-term opportunity appears to be intact. Data volume grows every day, and companies increasingly need applications to store and analyze their data. Teradata's valuation is attractive with the stock trading near a five-year low on a price-to-revenue basis. We used the recent price weakness to increase our position.

**U.S. Steel** is in the midst of a transformation to improve performance. The stock has been hit hard by low energy prices, the subsequent slowdown in energy-related capital spending, pricing weakness and high levels of imports. We expect that new trade legislation and improving market conditions, coupled with the company's internal changes, should result in significantly better earnings. Trading near a five-year low on price-to-book value basis, we view U.S. Steel's valuation as attractive and have increased our position.

**Portfolio Changes**

Three stocks were eliminated from the portfolio during the second quarter. We sold our remaining positions in **Polypore** and **Hospira,** after both companies became takeover targets, and eliminated **Molson Coors Brewing,** which had more than doubled while we owned it.

We added two new names to the portfolio during the second quarter: Copa Holdings SA (CPA) and Domtar Corporation (UFS). **Copa Holdings** provides airline passenger service from its hub airport in Panama to North, Central and South America with a modern, fuel-efficient fleet. Weak economic growth in Latin America has put pressure on near-term earnings and provided us an opportunity to buy at an attractive valuation. The stock currently trades near a ten-year low on a price-to-book value basis and has a 4% dividend yield. We believe the company can significantly improve its profit margins once economic factors improve. **Domtar**, the largest paper and pulp producer in North America, is expanding its more profitable personal care segment. The stock is trading below book value and has a dividend yield of 3.8%.

**Perspective and Outlook**

With a backdrop of ongoing global disruptions, the outlook within the U.S. remains positive. The U.S. economy is recording reasonable growth after a slow start due to bad weather early in the year. Unemployment rates are declining, job openings are increasing, wages are improving, and consumer spending, automobile sales and capital spending are recording modest growth. Merger, acquisition and spinoff activity continues. Oil prices increased early in the second quarter and remained fairly stable throughout the period.

The strength of the U.S. dollar continues to be a headwind for many companies with significant revenues from international markets. We view this as a short-term disruption. Energy prices remain relatively low benefiting consumers.

While we are disappointed with recent performance, we consider the portfolio well-positioned with both attractive valuation and strong fundamentals. The Fairpointe Mid-Cap portfolio remains attractively valued. The portfolio's price-to-sales ratio of 0.8 times is currently 50% below the S&P 500, which should be positive for additional M&A activity. The portfolio currently trades at 15.9 times 2015 consensus earnings estimates, while the mid cap benchmarks S&P 400 and Russell Midcap Indices, trade at 19.3 and 19.4 times 2015 consensus estimates, respectively. We expect the portfolio to benefit from the ongoing economic recovery. Our focus on company-specific fundamentals and valuation are the drivers of our long-term outperformance. In the short term, these factors can be and have been overshadow by global concerns. We think the market will refocus on company-specific fundamentals during the next few weeks when companies report second quarter results.

Thank you for your continued interest and support.

Thyra E. Zerhusen, Chief Investment Officer
Marie L. Lorden, Portfolio Manager
Mary L. Pierson, Portfolio Manager

## DISCLOSURE

| Year End | Total Firm Assets (USD) (millions) | Composite Assets (USD) (millions) | Composite Number of Accounts | Annual Performance Results Composite Gross | Annual Performance Results Composite Net | S&P MidCap | Russell MidCap | Composite Dispersion |
|---|---|---|---|---|---|---|---|---|
| 2014 | 7,733 | 7,389 | Seven | 10.79% | 9.97% | 9.77% | 13.22% | 0.38% |
| 2013 | 6,999 | 6,692 | Seven | 45.67% | 44.58% | 33.50% | 34.76% | 1.00% |
| 2012 | 3,853 | 3,633 | Six | 17.76% | 16.83% | 17.88% | 17.28% | N.A. |
| 2011 | 3,398 | 3,210 | Five or Fewer | (5.36%) | (6.10%) | (1.73%) | (1.55%) | N.A. |
| 2010* | - | 2,871 | Five or Fewer | 24.49% | 23.50% | 26.64% | 25.48% | N.A. |
| 2009* | - | 1,493 | Five or Fewer | 66.28% | 65.03% | 37.38% | 40.48% | N.A. |
| 2008* | - | 722 | Five or Fewer | (42.05%) | (42.53%) | (36.23%) | (41.46%) | N.A. |
| 2007* | - | 1,176 | Five or Fewer | 13.81% | 13.02% | 7.98% | 5.60% | N.A. |
| 2006* | - | 848 | Five or Fewer | 22.21% | 21.27% | 10.32% | 15.26% | N.A. |
| 2005* | - | 695 | Five or Fewer | 2.67% | 1.83% | 12.56% | 12.65% | N.A. |

*Information presented prior to May 1, 2011 pertains to portfolios managed by the Portfolio Managers while affiliated with prior firms. The presentation conforms to GIPS® guidelines regarding the portability of investment results.
N.A. – Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

Mid-Cap Composite contains fully discretionary equity accounts that follow the mid-cap style. Mid-Cap Composite represents portfolios that seek long-term total return through capital appreciation by investing primarily in mid-cap stocks. For comparison purposes the composite is measured against the S&P MidCap 400 and Russell MidCap indices. The S&P MidCap 400 is a market value weighted total return index that represents the performance of the medium-capitalization sector of the U.S. Securities market. The Russell MidCap is a market value weighted total return index that represents the midcap segment which measures the performance of the 800 smallest companies in the Russell 1000 index. Both indices are representative of the types of equity assets invested by Fairpointe Capital. Market indices are unmanaged and do not reflect the deduction of fees. You cannot invest in an Index and the performance of the Index does not represent the performance of any specific investment. The minimum account size for this composite is $2.5 million. Prior to May 1, 2011 the account minimum was $5 million. Effective March 31, 2013, the account minimum has gone back to $5 million.

Fairpointe Capital LLC (Fairpointe) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Fairpointe has been independently verified for the periods May 1, 2011 through March 31, 2015.

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 Mid-Cap composite has been examined for the periods May 1, 2011 through March 31, 2015. The verification and performance examination reports are available upon request.
Fairpointe Capital is an independent registered investment adviser. The firm maintains a complete list of composite descriptions which are available upon request. Please send inquiries to mkatauskas@fairpointecapital.com or call 312-477-3300.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Past performance is not indicative of future results. Market, economic, company, and industry specific conditions are considered during the investment selection process. This was a period of generally declining security prices.

The U.S. Dollar is the currency used to express performance. Returns are presented gross and net of management fees and include the reinvestment of all dividends, capital gains, and other earnings. Gross returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. Net of fee performance is calculated using actual fees. The annual composite dispersion is an asset-weighted standard deviation calculated for the accounts in the composite the entire year. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

The investment management fee schedule for the composite was 1.0% on the first $10 million and 0.65% on the remainder. Effective March 31, 2013, the fee schedule is 0.85% on the first $10 million and 0.65% on the remainder. Actual investment advisory fees incurred by clients may vary.

At December 31, 2014, the three-year annualized ex-post standard deviation of the composite is 13.4% and the benchmarks are 11.1% S&P MidCap and 10.1% Russell MidCap, respectively. At December 31, 2013, the three-year annualized ex-post standard deviation of the composite is 18.4% and the benchmarks are 15.0% S&P MidCap and 14.0% Russell MidCap, respectively. At December 31, 2012, the three-year annualized ex-post standard deviation of the composite is 20.6% and the benchmarks are 17.9% S&P MidCap and 17.2% Russell MidCap, respectively. At December 31, 2011, the three-year annualized ex-post standard deviation of the composite is 25.0% and the benchmarks are 21.9% S&P MidCap and 21.6% Russell MidCap, respectively.

The Mid-Cap Composite was created May 1, 2011. Performance presented prior to May 1, 2011 occurred while the Portfolio Managers were affiliated with prior firms and the Portfolio Managers were the only individuals responsible for selecting the securities to buy and sell.