FAIRPOINTE CAPITAL

FAIRPOINTE ESG EQUITY STRATEGY

3RD QUARTER COMMENTARY 2018

As of September, Fairpointe Capital LLC is proud to be a signatory of the Principles for Responsible Investment (PRI). By signing this agreement, we formally acknowledge our commitment to incorporating ESG factors into our investment analysis and decision-making process. This commitment is an extension of our long-established active ownership and engagement with our portfolio companies.

The United Nations climate report published in October highlights the impending risks of increased greenhouse gases and temperatures around the world. The concern is very real, and we are already seeing the impact globally and in the U.S. with greater destruction from hurricanes, wild fires, and floods. Global warming is accelerating the rate of sea level rise, which increases the flooding risks to low-lying communities as well as to high-risk coastal properties. Wildfires are increasing and lasting longer as temperatures rise. Hurricanes are a natural part of our climate, but research indicates that their intensity is increasing. As temperatures rise, heat waves are more frequent and severe, and they create serious health risks from increased air pollution, longer allergy seasons, and the spread of insect-borne diseases, which we know increase health care costs. Droughts are also on the rise and threaten food and groundwater supplies. These changes have already exacted significant costs and over time will lead to food shortages, health issues, and changes in migration patterns. A small set of fossil fuel producers are responsible for 71% of global emissions. None of these companies are held, and our portfolio has a very low carbon footprint, as measured by MSCI ESG Research LLC.

In terms of governance, there is an increasing emphasis on the diversity of corporate boards. As an example, in October California enacted a law requiring publicly-traded companies that are headquartered in the state to have at least one woman on their boards by the end of 2019 (with higher numbers required over time). We believe goal setting will help encourage accountability by pushing companies to measure and report their progress. Research indicates that board diversity is highly correlated with improved shareholder value and company performance. Diversity on key committees, such as nominating and compensation, also contributes to improved governance. Of course, we require qualified women to serve on the boards of the companies we invest in, just like we scrutinize all board members for their qualifications. Of our 42 current holdings, all of them have at least one female director, and ten have surpassed the 30% target espoused by The Thirty Percent Coalition (founded in 2011, is a pioneer advocacy organization, working for diversity in the corporate boardroom).

As portfolio managers of an ESG strategy, our objective is to find companies that have strong ESG characteristics and that will outperform the market over the long term. We work actively with management teams in order to assess their awareness of environmental, social, and corporate governance issues. For over ten years, we have served as active shareholders who use proxy voting processes, as well as regular engagement with management, to support positive changes. Corporate diversity (both at the board level and management) is a key focus, along with our attention to environmental impact policies and demonstrated commitment to employee welfare.

Market Conditions Lining Up to Favor Value

Market volatility continued in the third quarter, as concerns about trade wars and the global economic outlook persisted. Overall, however, U.S. equities had a strong quarter, driven by robust earnings reports, tax cuts and share buybacks. We are pleased to report that our portfolio generated positive returns for the quarter, up 0.76%, but disappointed that we trailed the Russell 1000® Index benchmark, which returned 7.42% over the same period.

Investor sentiment and market trends have favored growth and momentum-oriented equities relative to value stocks for the past few years. The fund flows into passive investments, index funds, and ETFs have amplified the performance divergence between growth and value stocks. Our portfolio has been at a disadvantage in this environment because our investment process has a strong valuation component.

Several macro-economic factors point to a possible shift in the market's momentum from growth to value. A more restrictive monetary policy, rising inflation, and continued threats of a global trade war could produce a broader slowdown, which would likely create difficulty for growth equities and favor companies with stronger long-term fundamentals, like those in our portfolio.

Our portfolio has begun to experience this change and many stocks have been rewarded, as their long-term earnings potential is finally being recognized. Qualcomm was our top performer for the past quarter, up 29%. The company significantly cut costs and initiated a large $16 billion accelerated share buyback – over 15% of its current market value of $103.5 billion. Qualcomm also received an International Trade Commission ruling confirming Apple's infringement on one of its patents. We see significant value in the intellectual property that the company has created and believe it will significantly benefit from the 5G rollout. Although several significant legal issues still need to be resolved, we believe that these concerns are reflected in the current stock price.

Juniper Networks, the second largest contributor during the past quarter, was up 10%. Juniper held an investor meeting in September to lay out the case that the company would significantly benefit from its substantial investments in the 5G telecommunications infrastructure. The long-awaited investments have begun—as announced by Verizon recently—and are expected to include $50 billion in spending by 2020 that is directly addressable by Juniper products, according to the company. The transformation should also result in higher margins, given that the products will be mostly software. The company will hold another investor meeting in early November, which could be an additional catalyst for the stock.

Another strong performer was TEGNA, which returned 11% during the quarter and was our third best contributor. TEGNA reported second-quarter earnings above expectations due to strength in both political and subscription revenue. The company also announced it will acquire two leading television stations in markets adjacent to current holdings in Ohio and Texas. These acquisitions are part of the company's strategy to acquire stations in and near existing stations in order to realize synergies. The stock may have also been buoyed by renewed talks by Tribune Media to sell itself, raising speculation of a new round of consolidation in the media space. Corporate governance is strong, and the company has a reputation as a great place to work, according to the Human Rights Campaign for offering inclusive benefits to transgenders such as health insurance coverage.

In our second quarter commentary, we discussed the uncertainty created by the U.S. administration's tariffs. Fears of a global trade war continued into the third quarter and seem likely to persist for the foreseeable future, creating further uncertainty in the markets and increasing the possibility of higher inflation. Many management teams have indicated to us that they intend to increase prices in order to pass on the higher costs from tariffs, raw materials and labor to their customers.

Some companies had been protected from—and were even helped by—the initial round of tariffs but are now having to grapple with the longer-term effects.

Our largest detractor was Dean Foods, down 32%. We invested in the largest and lowest cost dairy producer as a contrarian thesis that milk consumption would stabilize and that the company's diversification efforts would ultimately pay off. While the dairy industry does have a higher carbon footprint than we prefer, milk does provide a low-cost protein source to consumers. The company established sustainability goals in 2008 and has significantly reduced its energy and water usage, decreased its waste production, and increased its recycling efforts. Dean Foods has ambitious goals for 2020, including diversifying its product line into organic and plant-based products. We have added to our position with the downturn in anticipation of a re-rating of the stock. In the meantime, we are receiving a 5% dividend yield.

Our second largest detractor for the quarter was General Electric, down 16%. After disappointing results in the company's power segment, a new CEO was named, Larry Culp, formerly a star performer at Danaher. We like the fact that his compensation is heavily weighted to stock appreciation. The other two core divisions of aviation and healthcare are performing in line with expectations and are producing sustainable energy systems like digital wind farms, oxide fuel cells, and new locomotive engines with significantly reduced emissions.

Varex Imaging, down 23%, was the third largest detractor. The company is a leading provider of imaging components used for medical therapy and industrial security. The company was spun off from Varian Systems and has a team new to managing a public company. The management team has established a sustainability strategy, affecting every part of their business—starting with the customer and then extending to local communities, to manufacturing, to the environmental footprint, and to acting with integrity. The decline in the stock has been primarily due to weakness in earnings that are the result of the impact of tariffs and trade wars with China. We added to our position on the correction in the stock.

Bristol-Meyers Squibb and IBM also contributed to performance in the quarter, while Molson Coors Brewing and McDermott International detracted.

Portfolio Changes

This quarter, we added Cars.com, Magna International, ManpowerGroup, New York Times, Owens Corning, and Smith & Nephew.

In our assessment, Owens Corning is well positioned to raise its prices to offset higher operating costs. We bought Owens Corning stock after investors over-reacted to what we consider short-term operational issues. The stock was previously owned in our mid-cap core portfolio, and we know the company and management team well. Although there are concerns that housing starts may slow due to higher interest rates, Owens Corning will remain insulated from this trend as only 12% of its revenues are generated from new home construction. After being embroiled in asbestos claims many years ago, the company has re-made itself with a strong sustainability effort across all areas of the company and has proved that corporate reputations can be re-made.

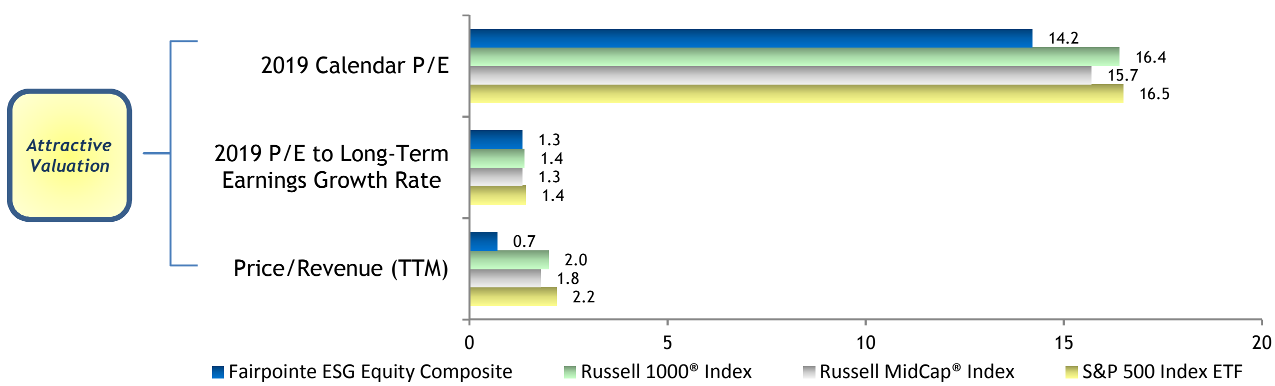
We took advantage of a sharp decline in Manpower's stock price. The stock is suffering from uncertainty surrounding changes to the French labor subsidies that will be implemented in 2019. Based on our past ownership of Manpower, we expect the company will be able to offset declines in subsidies. In addition, the strong labor environment in the U.S. will help the company's revenues and margin profile in the U.S. Manpower has a stellar ESG record with strong governance, good labor management, and no carbon emissions issues.

Portfolio Positioning and Outlook

The below chart demonstrates the value within the portfolio. The valuation of the portfolio continues to have a significant discount to that of the market—with a P/E of 14.2x 2019 projected earnings, compared to 16.4x for Russell 1000® Index.

PORTFOLIO FUNDAMENTALS

SEPTEMBER 30, 2018



The above information is based on a representative account. The information is provided for illustrative purposes only and is not indicative of the composition of any particular client's investment portfolio or its performance. Each client's portfolio will vary as to the investments held and their performance depending upon the client's particular needs and objectives. The above information is supplemental to a full presentation of the ESG Equity composite. Further disclosures are found on the last page.

Source: Zacks

Our stock purchases and sales remain guided by a fundamental bottom-up approach with a careful eye on valuation and long-term perspective. We integrate this fundamental investment analysis with our ESG evaluation with a focus on the carbon footprint and diversity within the company and board. We continue to believe that companies that behave responsibly with attractive valuations and sustained earnings will be recognized by the market.

Thank you for your continued interest and support.

Thyra E. Zerhusen, Chief Investment Officer
Mary L. Pierson, Portfolio Manager
Frances E. Tuite, CFA, Portfolio Manager

DISCLOSURE

The ESG Equity Composite includes all fully discretionary equity accounts that invest in all cap equities with no fixed income exposure. The ESG Composite represents portfolios that seek to invest in companies that adhere to good environmental, social and governance practices. For comparison purposes the composite is measured against the Russell 1000 index. The Russell 1000 is a market capitalization-weighted index made up of 1,000 large cap stocks that account for upwards of 90% of the market capitalization of companies traded in the U.S. The index is 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.

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 June 30, 2018.

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 verification 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 any accounts that would no longer be 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 rising 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 is 0.85% on the first $10 million and 0.65% on thereafter. Actual investment advisory fees incurred by clients may vary.

The three-year annualized ex-post standard deviation of the composite and the benchmarks are not presented because the composite did not exist prior to 2014.

The ESG Equity Composite was created January 1, 2018.